92-324

No. ——

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

EUGENE H. DUFFY, *et al.*,
Petitioners,

v.

JAMES W. WETZLER, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the New York Supreme Court Appellate Division—Second Department

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PETITION FOR A WRIT OF CERTIORARI

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September 22, 1992

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QUESTIONS PRESENTED

1. Whether 4 U.S.C. § 111 and this Court's decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

2. Whether an action brought under 42 U.S.C. § 1983 in a state court may be defeated by the assertion of state procedural and substantive defenses, where such defenses would not be available if the action had been brought in a federal forum.

PARTIES TO THE PROCEEDING

The parties to the proceedings in the Appellate Division—Second Department were Petitioners Eugene H. and Alice G. Duffy, James Sweezy,* Fernando S. Maura on behalf of themselves and on behalf of all others similarly situated;** intervenors, Albert and Judith Engel, Ettore and Vivian Delzio, Harvey Gottlieb, Stanley L. and Mildred Goldstein, Peter M. and Mary T. Kaley, Daniel J. and Margaret A. Maher, Thomas F. Molloy, Joseph A. and Rita M. O'Sullivan, Irving and Helen Wax on behalf of themselves and on behalf of all others similarly situated; *** and Respondents James W. Wetzler, individually and as New York State Commissioner of Taxation and Finance, Roderick G.W. Chu, individually, Edward V. Regan, individually and as Comptroller of the State of New York, Anthony Shorris, Stanley F. Grayson, Abraham Biderman and Paul Crotty, individually and as present or former Commissioners of Finance of the City of New York, and the City of New York.

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* Agnes Sweezy, wife of James Sweezy, who was a party to the proceedings below, died on July 31, 1992. James Sweezy is Agnes Sweezy's successor-in-interest.

** In the proceedings below, the petitioners' motion to certify this case as a class action on behalf of approximately 100,000 similarly situated civilian and military annuitants of the federal government was denied.

*** The intervenors' motion to intervene in this case was denied. The interests of the intervenors have been preserved by stipulation among the parties.

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Petition for a Writ of Certiorari to the New York Supreme Court Appellate Division—Second Department

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PETITION FOR A WRIT OF CERTIORARI

Engene H. Duffy, Alice G. Duffy, James Sweezy and Fernando S. Maura, on behalf of themselves and on behalf of all others similarly situated, respectfully petition this Court for a writ of certiorari to the New York Supreme Court Appellate Division—Second Department.

OPINIONS BELOW

The opinion of the Appellate Division, Second Department is reported at 174 A.D.2d 253, 579 N.Y.S.2d 684, and is reprinted in the appendix hereto at App. A at 1a.

The Appellate Division, Second Department in its decision affirmed in part and reversed in part the decision of the Supreme Court of the State of New York, Queens County (the Honorable Alan Levine). The Supreme Court of the State of New York's decision is reported at 148 Misc. 2d 459, 555 N.Y.S.2d 543, and is reprinted in

the appendix hereto at App. B at 25a. Its order and judgment are reprinted in the appendix hereto at App. C at 39a.

JURISDICTION

The opinion of the Appellate Division, Second Department was entered on January 15, 1992. Petitioners sought review of the opinion dated January 15, 1992 by filing a Notice of Appeal with the New York State Court of Appeals as of right pursuant to N.Y. CPLR 5601 (b)(1). The New York State Court of Appeals, however, dismissed petitioners' appeal in a *sua sponte* order. The New York State Court of Appeals' *sua sponte* order was dated April 7, 1992, and is reprinted in the appendix hereto at App. D at 51a.

On May 5, 1992, petitioners filed a motion for leave to appeal to the New York State Court of Appeals pursuant to N.Y. CPLR 5602(a)(1)(i) and 5514(a). The New York State Court of Appeals denied petitioeners' motion. The New York State Court of Appeals' order was dated July 7, 1992, and is reprinted in the appendix hereto at App. E at 58a. Jurisdiction to review the decision herein by writ of certiorari is conferred upon this Court by 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

4 U.S.C. § 111 provides in relevant part:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

42 U.S.C. § 1983 provides:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State

> or Territory or the District of Columbia, subjects or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity or other proper proceeding for redress.

The Supremacy Clause of the United States Constitution, Article VI, Cl. 2 provides in relevant part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the land; and the Judges in every State shall be bound thereby, any thing in the Constitution or Laws of any State to the contrary notwithstanding.

The Due Process Clause and Equal Protection Clause of the United States Constitution, Amendment XIV, provide in relevant part:

> . . . [n]or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Pertinent provisions of the statutory schemes of the State and City of New York as well as the provisions of the CPLR are set forth in App. F at 60a.

STATEMENT OF THE CASE

This case arises in the wake of this Court's decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). In *Davis*, this Court held that state taxing schemes which discriminate in favor of local and state retirees and against federal retirees are invalid under 4 U.S.C. § 111. The State and City of New York, similar to the State of Michigan and approximately twenty other states, exempted the benefits of all retired employees of state and local government from state and local income taxation while taxing federal pensions. App. A at 4a.

On May 9, 1989, the petitioners, who are retired employees of the federal government, commenced this class action suit in New York state court on behalf of themselves and all others similarly situated challenging the constitutionality of New York State's and City's discriminatory schemes, seeking, *inter alia*, declaratory and injunctive relief under 42 U.S.C. § 1983 and state law to enjoin the continued enforcement of the State's and City's discriminatory schemes of taxation and seeking refunds of the unconstitutionally collected taxes for the years 1986, 1987 and 1988. App. B at 25a. The petitioners moved before the trial court for partial summary judgment on their cause of action for declaratory relief. App. B at 25a.[1] The respondents cross moved for summary judgment dismissing the complaint. App. B at 25a.

By Memorandum Decision dated April 10, 1990, the trial court granted petitioners a declaratory judgment holding that:

> (1) The City and State personal income tax scheme which taxed federal pension benefits received prior to January 1, 1989, while exempting from taxation State and local pension benefits, is discriminatory, invalid and unconstitutional in light of *Davis* (*supra*);
>
> (2) The City and State defendants therefore may not assess and collect personal income taxes on federal pension benefits received in years 1986 through 1988, which may be still due and owing;
>
> (3) Plaintiffs are entitled to a refund of that portion of their personal income taxes which was paid on federal pension benefits for the years 1986 through

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[1] Subsequent to the commencement of this suit, the Legislature of the State of New York amended Tax Law § 612(c)(3) and New York City Administrative Code § 11-1712(c)(3) by removing the unconstitutional provision that discriminated against federal retirees. This remedial legislation applies *only* to tax years 1989 and after.

1988, provided that they file for a refund and meet the procedural requirements for a refund under the Tax Law.

See App. B at 37a.[2]

The trial court also granted petitioners reverse summary judgment on their claim for a permanent injunction and enjoined defendants from assessing and collecting income taxes on pension benefits which may be due and owing and further enjoined defendants from "interfering with plaintiffs' rights to file for refund of personal income taxes paid on federal benefits for the years 1986 through 1988." The trial court, however, denied petitioners' motion for class certification and granted defendants' summary judgment motion dismissing the first and fourth causes of action for damages under 42 U.S.C. § 1983 and for money had and received, respectively. The order and judgment was entered on June 26, 1990. However, upon application of the respondents, the judgment in favor of the petitioners was automatically stayed pending appeal, thus permitting the continued enforcement of the unconstitutional scheme throughout these proceedings. R2. 424-426, 477, 551.

On an appeal and cross appeal to the Appellate Division, that court modified the order and judgment by reversing the trial court's declarations and its issuance of an injunction. The Appellate Division concluded that this Court's decision in "*Beam* requires prospective application" of *Davis*. App. A at 3a. The Appellate Division also affirmed the trial court's dismissal of the petitioners' claims under 42 U.S.C. § 1983 and its denial of petitioners' motion for class certification.

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[2] Petitioners have satisfied all procedural requirements imposed by the New York Tax Law. *See, e.g.*, R. 514; R2. 639. ("R" refers to Part I of the record on appeal pages 1-536 and "R2." refers to Part II of the record on appeal pages 1-769.).

Petitioners sought review as of right of the Appellate Division's decision by filing a Notice of appeal with the New York State Court of Appeals pursuant to CPLR 5601(b)(1). The New York State Court of Appeals, however, dismissed petitioners' appeal in a *sua sponte* order dated April 7, 1992. App. D at 51a.

On May 5, 1992, petitioners filed a motion for leave to file an appeal with the New York State Court of Appeals pursuant to CPLR 5602(a)(1)(i) and 5514(a). The New York State Court of Appeals denied petitioners' motion in an order dated July 7, 1992. App. E at 58a. Petitioners are now seeking a writ of certiorari to review the judgment of the Appellate Division, Second Department.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW EVISCERATES THE HOLDINGS OF THE COURT IN *DAVIS* AND *BEAM*.

On May 18, 1992, this Court granted certiorari in *Harper v. Virginia Dep't of Taxation*, 242 Va. 322, 410 S.E.2d 629 (1991), *cert. granted*, No. 91-794, —— U.S. ——, 112 S. Ct. 1934 (1992). This case, like *Harper*, presents the question of whether states and cities may refuse, under any circumstances, to refund taxes collected in violation of the Supremacy Clause and 4 U.S.C. § 111 by the device of a prospective-only application of *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). This is the same question that this Court addressed in its remand orders at the conclusion of its 1990 term. *See Harper v. Virginia Dep't of Taxation*, —— U.S. ——, 111 S. Ct. 2883 (1991); *Bass v. State of South Carolina*, —— U.S. ——, 111 S. Ct. 2881 (1991). *Cf. Norwest Bank Duluth, N.A. v. James*, —— U.S. ——, 111 S. Ct. 2881 (1991).[3] The court below "misconceived the appro-

[3] *See also United States v. City of Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, —— U.S. ——, 111 S. Ct. 2888 (1991)

priate analytical task," *Patterson v. Shumate*, —— U.S. ——, 112 S. Ct. 2242, 2248 n.4 (1992), in reaching its holding that "*Beam* requires prospective application" of *Davis*. App. A at 3a.

As in *Harper*, review by this Court is necessary to prevent the principles and holdings of this Court's decisions from being eviscerated by result-oriented state court decisions.[4] Absent review by this Court, several states will continue to refuse "to enforce [the statute] according to its terms."[5] *West Virginia Univ. Hosp.*,

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(ordering refunds of taxes exacted in violation of the intergovernmental tax immunity doctrine).

[4] This petition is the sixth to be filed with this Court within the last year involving the merits of a state's refusal to refund taxes collected from federal retirees in violation of the intergovernmental tax immunity doctrine and 4 U.S.C. § 111. *See Barker v. Kansas*, No. 91-611, *rev'd*, 112 S. Ct. 1619 (1992); *Harper v. Virginia Dep't of Taxation*, *cert. granted*, No. 91-794; *Swanson v. North Carolina*, No. 91-1436, *petition for cert. pending; Sheehy v. Montana Dep't of Revenue*, No. 91-1473, *petition for cert. pending*; and *Bass v. State of South Carolina*, No. 91-1697, *petition for cert. pending*. Two additional petitions have been filed by states seeking, *inter alia*, to overcome their obligations under state refund laws to pay federal retirees refunds. *See Pledger v. Bosnick*, No. 91-375, *petition for cert. pending* (Arkansas); *Colorado v. Kuhn*, No. 91-980, *cert. dismissed*, 112 S. Ct. 1925 (1992).

[5] *See, e.g., Kerr v. Waddell*, TX 89-00153 (Arizona Tax Court, June 5, 1992), *appeal pending*, No. 1 CA 92-0010, where a trial court has been persuaded that, even as to tax years *after Davis*, its declaration invalidating a patently unconstitutional tax scheme, which discriminated in favor of *current* state employees and against *current* federal employees in violation of 4 U.S.C. § 111, was to be given "prospective" effect; *Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992), *petition for cert. pending sub nom., Norwest Bank Duluth, N.A. v. James*, No. 91-2047, in which the state court subverted the mandate of this Court in *James B. Beam Distilling Co. v. Georgia*, —— U.S. ——, 111 S. Ct. 2439 (1991), by awarding the taxpayers *de facto* prospective-only relief. Petitioners also understand that following this Court's recent decision in *Barker v. Kansas*, —— U.S. ——, 112 S. Ct. 1619 (1992), the

Inc. v. Casey, —— U.S. ——, 111 S. Ct. 1138, 1147 (1991) (citation omitted). *See also Patterson v. Shumate*, 112 S. Ct. at 2247; *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989).

A. A State Court Does Not Have the Power to Change the Effective Date of a Congressional Enactment.

In *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), the Court construed the "plain language" of 4 U.S.C. § 111 and concluded that the "statute leaves no room for doubt" that federal retirement benefits "are subject to § 111." *Id.* at 808-09. The conclusion of the court below that "*Beam* requires prospective application" [6]

State of Kansas is taking the position that *Barker* should be given prospective effect. Telephone interview with Kevin M. Fowler, Counsel for the petitioners in *Barker* (Sept. 3, 1992). *See also*, Tax News, Iowa Department of Revenue and Finance, August 1992, as reported in CCH State Tax Review August 31, 1992, announcing that the Iowa Department of Revenue will apply this Court's decision in *Kraft General Foods, Inc. v. Iowa Dep't of Revenue & Finance*, —— U.S. ——, 112 S. Ct. 2365 (1992) prospectively only.

[6] The court below purports to have applied *Davis* "prospectively." App. A at 3a. However, it made no effort to determine how it would have decided this case had it arisen before *Davis* was decided. Certainly, even without this Court's intervention in *Davis*, there could be no dispute that New York's tax scheme violated the intergovernmental tax immunity doctrine. *See Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 496 N.Y.S.2d 394, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986). Indeed, even when enacted, New York's scheme clearly violated the constitution. *See Graves v. New York*, 306 U.S. 466, 486-87 (1939) (irrespective of "whether the taxed income be salary or *some other form of compensation*," *the state's power is only to impose 'non-discriminatory'* taxes) (emphasis added). Thus, the Appellate Division's characterization of its decision as a "prospective" application is incorrect. Rather, it is merely a "nonapplication" of the intergovernmental tax immunity doctrine, 4 U.S.C. § 111 and *Davis*. However, " 'the sole function of the court below was to enforce [the statute] according to its terms.' " *West Virginia Univ. Hosp., Inc. v. Casey*, 111 S. Ct. at 1147 (citation omitted).

of *Davis* is fundamentally flawed in several respects and is unsustainable.[7]

In exercising its judicial function to enforce 4 U.S.C. § 111, the Appellate Division should have given effect to the considered decision of Congress in establishing the effective date of the Act. *See* Public Salary Tax Act of 1939, Title I, § 4 (App. G at 64a); *Meredith v. State Tax Comm'n*, 163 Or. 305, 312-13, 96 P.2d 1082 (1939) (recognizing that the effective date of the Act as enacted by Congress is controlling). A state court is "'not at liberty to create an exception where Congress has declined to do so.'" *Freytag v. Commissioner*, —— U.S. ——, 111 S. Ct. 2631, 2636 (1991) (citation omitted). *See also Patterson*, 112 S. Ct. at 2250 ("'[The statute] reflects a considered congressional policy choice . . . . If exceptions to this policy are to be made, it is for Congress to undertake that task.'") (quoting *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 376 (1980)). The preemption of New York's discriminatory tax was "compelled". *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 642 (1990) (citation omitted).

The decision below is irreconcilable with the Court's landmark decision of *M'Culloch v. Maryland*, 17 U.S. 316 (1819). The Appellate Division does not have the "power" to substitute its determination for that of Congress:

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[7] The decision below also conflicts with decisions of the United States Court of Appeals and the courts of last resort of other states. *See, e.g., Melton v. Moore*, 964 F.2d 880 (9th Cir. 1992); *United States v. City of Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, —— U.S. ——, 111 S. Ct. 2888 (1991); *Pledger v. Bosnick*, 811 S.W.2d 286 (Ark. 1991), *petition for cert. pending*, No. 91-375; *Kuhn v. State, Dep't of Revenue*, 817 P.2d 101 (Colo. 1991), *cert. dismissed*, —— U.S. ——, 112 S. Ct. 1925 (1992); *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (banc), *cert. denied*, 493 U.S. 1019 (1990). It also conflicts with the final decisions in the *Davis*-related cases of *Burns v. New Mexico*, No. SF 89-1314(c) (1st Jud. Dist. Santa Fe County, April 5, 1990) and *In re Schrick*, No. 90-5201 RPD (Tax Comm'r of W. Va., Sept. 23, 1991).

> [T]he States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government.

Id. at 439.

In a context analogous to the issues presented here, the Court has previously held that it does not possess the power which the Appellate Division purported to exercise below. In *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7 (1983), this Court invalidated a Hawaii statute that imposed a tax on gross income of airlines operating within the State because it had been pre-empted by Congress.[8] In so holding, this Court noted that it was bound by the determination of Congress:

> We acknowledge that our interpretation of § 1513(a) may result in the disruption of state systems of taxation; we are, however, *bound* by the plain language of the statute.

Id. at 14 n.10 (emphasis added).

The important issue of federalism decided by the court below presents a significant danger, the impact of which transcends the interests of federal retirees of New York and the hundreds of thousands of federal retirees whose rights under *Davis* are currently the subject of ongoing litigation in approximately thirteen states. The real danger that the holding below presents is that it will be readily extended by New York and other states to limit states' obligations to comply with congressional enactments involving the general welfare. However, no court

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[8] Prior pronouncements of the Court in the context of federal legislation involving a conditional waiver of intergovernmental tax immunity indicate that, absent a strict adherence to the requirements of such legislation, state tax enactments will be invalidated. *See, e.g., Chase Manhattan Bank, N.A. v. Finance Admin.*, 440 U.S. 447 (1979).

possesses the "veto" power which the Appellate Division exercised below. As the Court held in *Tennessee Valley Auth. v. Hill*, 437 U.S. 153 (1978):

> Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto.

Id. at 194-95.

It was error for the court below, under the guise of the prospectivity doctrine, to change the considered decision of Congress, which carefully weighed the equities in establishing the January 1, 1939 effective date of 4 U.S.C. § 111. *See* Public Salary Act of 1939, Title I, § 4; Title II, § 201 (App. G at 64a). Consistent with the command of the Supremacy Clause and *M'Culloch v. Maryland*, 17 U.S. 316 (1819), a grant of the petition for writ of certiorari in this case will permit this Court to resolve the uncertainty created in the law of the several states as the result of the decision below.[9]

B. *Beam* Requires That *Davis* be Applied Retroactively.

The decision of the court below was also foreclosed by its obligations under the Supremacy Clause as well as principles of *stare decisis*. *See McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 29 (1990) ("State courts must interpret and enforce faithfully the 'supreme Law of the Land' . . . ."). Although there were several opinions in *James B. Beam Distilling Co. v. Georgia*, —— U.S. ——, 111 S. Ct. 2439 (1991),

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[9] *Cf. Franklin v. Gwinnett County Pub. Sch.*, —— U.S. ——, 112 S. Ct. 1028, 1033 (1992) ("[O]ur government 'has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right.'") (*quoting Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 163, 2 L. Ed. 60 (1803)).

the mandate of this Court's judgment in *Beam* is unmistakable:

> [A]ny consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court. . . . Because the Court in *Bacchus* remanded the case solely for consideration of the pass-through defense, it thus should be read as having retroactively applied the rule there decided. . . . *Cf. Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 817, 109 S. Ct. 1500, 1508, 103 L. Ed. 2d 891 (1989).

Id. at 2445-46 (footnote and citations omitted).

In *Davis*, Michigan's concession as to the appropriate retroactive remedy would have been of no moment unless this Court first had found the scheme unlawful for the years at issue therein (1979-1984). *Davis*, 489 U.S. at 806-07. *Cf. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, —— U.S. ——, 112 S. Ct. 2365, 2373-74 (1992) (Rehnquist, C.J., dissenting) ("[A] stipulation between parties cannot bind this Court on a question of law."). After this Court had applied the rule of law to the litigants in *Davis*, it was error for the Appellate Division to adopt the respondents' pretext of the prospectivity defense to deny the petitioners retroactive relief. *Beam*, 111 S. Ct. at 2448.

C. Alternatively, Assuming This Court Determines That a Prospectivity Analysis May Be Applied in This Case, *Davis* Should Be Given Retroactive Effect.

Even if *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), were an appropriate analytical vehicle, petitioners contend that an even-handed *Chevron* analysis requires that the provisions of 4 U.S.C. § 111 as construed in *Davis* be given retroactive effect.

1. The first prong of the prospectivity test requires that "the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed." *Ashland Oil, Inc. v. Caryl*, —— U.S. ——, 110 S. Ct. 3202, 3204 (1990) (per curiam) (citations omitted). Decisions must be retroactively applied if this threshold test is not met. *Id.* at 3205. The test under the first prong is a rigorous one, which is narrowly applied. *Id.* Since *Davis* "*was not revolutionary*," it does not meet the first prong. *Id.* (emphasis added).

The respondents contend that *Davis* decided an issue of first impression whose resolution was not clearly foreshadowed. However, any new principle of law implicated in *Davis* (if indeed there was one) was announced, not by this Court in 1989, but by Congress in 1939.[10] The holding in *Davis* is dispositive on this point:

> We have no difficulty concluding that civil service retirement benefits are deferred compensation for past years of service rendered to the Government.
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> * * * *
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> [T]he overall meaning of § 111 is *unmistakable*: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of . . . retirement benefits except to the extent that such taxation discriminates on account of the source of compensation.
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[10] *See South Carolina v. Baker*, 485 U.S. 505, 519 n.11 (1988) ("[The law has always been that] [t]he Federal Government . . . possesses the power to enact statutes immunizing those with whom it deals from state taxation even if [the] intergovernmental tax immunity doctrine would not otherwise confer an immunity."). Indeed, to the extent Congress' 1939 enactment stated a new principle, it "simply codified the result in *Graves*." *Davis*, 489 U.S. at 812.

> Any other interpretation of the nondiscrimination clause [of 4 U.S.C. § 111] would be implausible at best.

Davis, 489 U.S. at 808-10 (citations omitted).[11] In light of the ease with which this Court reached its conclusions in *Davis*, and in light of that decision's precedential underpinnings, the contention that *Davis* could satisfy the threshold *Chevron* test is "implausible at best." *Id.* at 810. *See also United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991) ("Our decision striking down this tax does not meet the tests of nonretroactivity. We overrule no precedent and we do not decide an issue of first impression.").[12]

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[11] Since the early 1920's, the law of New York has provided that pensions represent deferred compensation for past years of service. *See Matter of Marx v. Bragalini*, 6 N.Y.2d 322, 332, 189 N.Y.S.2d 846, 160 N.E.2d 611 (1959) ("[T]he New York Personal Income Tax Law was modeled on the Federal law and the definition of gross income paralleled that in the Federal act."). The federal law, as adopted by New York, has provided since its enactment that pensions or retiring allowances paid by the United States or private persons were compensation for personal services. *See, e.g.*, Treas. Reg. 45, Art. 32 (1919); Treas. Reg. 74, Art. 52 (1929); Treas. Reg. 101, Art. 22(a)-2 (1939).

[12] Even without the intervention of the *Davis* decision, the controlling authority of New York's highest court and settled administrative rulings clearly foreshadowed the outcome of this issue. *See Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 252-53, 496 N.Y.S.2d 394, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986) (rejecting the City's rational basis for discrimination in the context of intergovernmental tax immunity doctrine and holding that "[t]hat the disparities may be rational for due process or equal protection purposes, however, is not relevant" under the doctrine) (citing *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983) and *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376 (1960)); I.T. 1607, II-2 C.B. 71 (1923) ("Inasmuch as salaries and wages received by officers and employees of a State are exempt from taxation . . . it is held that the retirement allowance given employees of the State of New York under the New York State Employees' Retirement System represents compensa-

2. Had a meaningful inquiry been undertaken in the decision below, the Appellate Division would have been forced to conclude that the purpose of the rule could be furthered only by retrospective operation. That court's failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule.

In *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466, *reh'g denied*, 292 U.S. 604 (1934), the Court observed that:

> [The] application [of the intergovernmental tax immunity doctrine] does not depend upon the *amount of exaction, the weight of the burden or the resulting interference with sovereign independence.* Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree. . . . Its right application is essential to the orderly conduct of the national and state governments and the attainment of justice between them.

Id. at 471 (emphasis added).

As recently observed by the Ninth Circuit in an analogous case, the rule of law implicated in this case involves a "fundamental principle," *United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991), which had its genesis in *M'Culloch v. Maryland*, 17 U.S. 316 (1819). Retroactive application of the decision here "will surely foster a proper

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tion for past services rendered and is exempt from taxation."); I.T. 2669, XII-1 C.B. 68 (1933) (pensions paid to a person who rendered services as an officer or employee of a State or political subdivision thereof "represent compensation paid for past services rendered, and since the compensation in such cases was exempt from Federal income tax the pensions are also exempt from Federal income tax."). *See also* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28 (recognizing that the part of *current* pension payments received by state and local retirees, which is attributable to employer contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Public Salary Act).

respect for that principle," *United States v. City of Spokane*, 918 F.2d at 89, by encouraging states to tread carefully when they impose taxes upon those who deal with the federal government.[13] It appears that this principle is now observed by some only in the breach. *See Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992), *petition for cert. pending*, No. 91-2047.

3. The balance of equities here is entirely and decidedly in favor of the petitioners. As this Court held in *Owen v. City of Independence*, 445 U.S. 622, 654, *reh'g denied*, 446 U.S. 993 (1980):

> It hardly seems unjust to require a municipal defendant which has violated a citizen's constitutional rights to compensate him for the injury suffered thereby. . . . Elemental notions of fairness dictate that one who causes a loss should bear the loss.

The only prejudice to the respondents is that they will have to pay refunds of taxes which they were never entitled to collect or keep in the first instance. The economic burden on the state—even given its claims of fiscal woes—is non-existent. Neither the State nor City ever relied on the revenues from these taxes in formulating their budgets and therefore, cannot claim equitable considerations as a basis for denying relief. App. B at 33a; R. 28.[14] Indeed, the respondents' claims are mere cant. The state routinely pays hundreds of millions of dollars annually in income tax refunds to millions of income tax-

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[13] Retroactive application here will also have the salutary effect of deterring future "result-oriented decision[s] arrived at for the [sole] purpose of protecting the State's coffers." *Sheehy v. State, Dep't of Revenue*, 820 P.2d 1257, 1269 (Mont. 1991), *petition for cert. pending*, No. 91-1437 (Trieweiles, J., dissenting).

[14] The discriminatory taxing scheme has been in existence since 1949. Petitioners seek only the three years of unconstitutional taxes which are open under the statute of limitations. Thus, the respondents' contention below that the return of three years of taxes while retaining the remaining 47 years is somehow inequitable, is absurd.

payers. For example, in May of 1991 alone, the state paid 1.6 million taxpayers refunds averaging $270 each and totalling over $400 million. This was in addition to 4 million similar taxpayer refund claims processed and paid during the early part of the April 1991 filing period. *See* The New York Times, May 14, 1991, at B3. Similarly, the City's claims are meritless. It claims it cannot afford to refund a few million dollars to these elderly citizens, yet, it is sitting on a *budget surplus* of over $500 million. *See* The New York Times, May 31, 1992, at —. The State and City "cannot object to a refund here just because [they have] other ideas about how to spend the funds." *McKesson*, 496 U.S. at 51.

It certainly is not a proper judicial function for a court to determine how much of a refund a state can afford (particularly with no evidentiary record to support its conclusion) and then determine at what point a refund becomes so expensive that the underlying conduct must be deemed miraculously transformed from unlawful to lawful. Moreover, it is perverse to suggest, yet the Appellate Division implicitly held, that the larger the magnitude of the state's constitutional violation, the greater the state's equitable claim not to remedy it.

The taxpayers here are not sophisticated multi-state business enterprises. They are average, law-abiding citizens who complied with the mandates of New York law in reliance on their assumption that the State and City of New York are honorable governments. For purposes of weighing the equities they should not now be penalized by the State and City of New York for complying with their laws. "The need today for governmental revenue is indeed great, but not so great as to justify, the stingy . . . interpretation the [respondents] here espouse[]. The [states are] not that hard up." *American Standard Watch Co. v. Commissioner of Internal Revenue*, 229 F.2d 672, 675 (2d Cir. 1956).

II. THE PETITIONERS HAVE BEEN DENIED A CLEAR AND CERTAIN REMEDY.

1. The decision of the Appellate Division is unprecedented. It adopts, as the substantive holding of the case, the "contrived" contentions of the respondents. *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 42 (1990). The statutory refund right under the personal income tax law of New York is not conditioned by or subject to a threshold determination of prospectivity. The New York refund right is inherently retroactive. *See* section 687(a) of the Tax Law, App. F. at 60a; App. B at 32a-33a. Indeed, consistent with this settled right, simultaneously with the prosecution of this case, the Attorney General of New York represented to the federal courts that prospectivity is not a defense under the personal income tax law of New York. *See Hardwick v. Cuomo*, 891 F.2d 1097, 1105-06 (3d Cir. 1989). R. 439-41. It was error for the Second Department to have even permitted the Attorney General to raise the defense in this case, let alone prevail on the basis of the defense. *See Environmental Concern, Inc. v. Larchwood Constr. Corp.*, 101 A.D.2d 591, 476 N.Y.S.2d 175, 177 (2d Dep't 1984) ("We cannot tolerate this playing, 'fast and loose with the courts' . . . .") (citations omitted).[15] The lengths to which the court below had to go to reach its result clearly suggest that the decision is an "essentially arbitrary" result reached solely to de-

[15] The duplicity of the respondents has now been replicated before this Court. In a recently filed *amicus* brief, the City asserts "no case was brought in the courts challenging the state and local employee exemptions until the *Davis* case was begun in 1984." *See* Amicus Curiae Brief of the City of New York in *Harper v. Virginia Dep't of Revenue*, No. 91-794, at 21. However, the respondents know that at least two unsuccessful challenges to New York's discriminatory scheme were commenced long before the commencement of the *Davis* case. *See In re Yurkus*, N.Y. State Tax Commission No. TSB-H-82 (371) I, 1982 N.Y. Tax Lexis 42, December 31, 1982; *In re Resnick*, N.Y. State Tax Commission, No. TSB-H-84 (25) I, 1984 N.Y. Tax Lexis 487, February 23, 1984; (R. 521-30).

feat the enforcement of a federal right. *Cf. Enterprise Irrigation District v. Farmer Mut. Canal Co.*, 243 U.S. 157, 164 (1917). *See also Lawrence v. Tax Comm'n of Mississippi*, 286 U.S. 276, 282-83 (1932).[16]

The New York legislature has assured New York income taxpayers that they will receive the benefit of all intervening administrative interpretations or court decisions. *In re Friedsam v. States Tax Comm'n*, 64 N.Y.2d 76, 484 N.Y.S.2d 807, 473 N.E.2d 1181 (1984). In acting upon a refund claim, the issue of prospectivity is irrelevant. *See Hardwick v. Cuomo*, 891 F.2d 1097, 1105 (3d Cir. 1989) ("[There is] not . . . a single case in which New York State refused to refund monies collected pursuant to a provision of the Tax Law or, specifically, the personal income tax law provisions of Article 22, later declared unconstitutional."). The refund right is limited solely by the time barriers set forth in the statute.[17] The lower court's decision represents a radical departure from clearly established state law and practice.

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[16] The lower court's application of *Chevron* is equally insidious. The court below implicitly transformed New York's ignorance of a federal statute into reliance in order to hold that the first *Chevron* prong had been satisfied. It also created from whole cloth a finding of inequity under the third *Chevron* prong, where the record establishes that neither the State nor the City relied on the revenues from these taxes. App. B, 33a; R. 28. Moreover, even if there had been reliance upon the revenues, the rule is not that every unconstitutional state statute, "like every dog, gets one bite, if anyone has relied on the statute to his detriment." *New York v. Cathedral Academy*, 434 U.S. 125, 130 (1977). *See also Franklin v. Gwinnett County Pub. Sch.*, 112 S. Ct. at 1037 ("Selective abdication of the sort [adopted] here would harm separation of powers principles . . . by giving judges the power to render inutile causes of action authorized by Congress through a decision that *no* remedy is available.") (emphasis in original).

[17] In this regard, New York's statutory refund right is similar to that of several other states. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77, 80 (Mo. 1989) (*banc*), *cert. denied*, 493 U.S. 1019 (1990) ("'If this state's tax refund statutes . . . apply,

By virtue of the lower court's unprecedented decision, the petitioners' vested right to refund has been defeated by the application of a defense not otherwise imposed on similarly situated New York personal income taxpayers. *See Hardwick v. Cuomo*, 891 F.2d 1097, 1105 (3rd Cir. 1989).[18] The arbitrary application in this case of unstated standards by the Second Department in clear contravention of the settled tax refund practice and law of the state, represents an unlawful taking which is "plainly untenable." *Ward v. Love County*, 253 U.S. 17, 22 (1920).[19] *Cf. Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673 (1930).

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then all other issues [including the prospectivity defense] are irrelevant.'") (citation omitted); *Kuhn v. State, Dep't of Revenue*, 817 P.2d 101 (Colo. 1991), *cert. dismissed*, —— U.S. ——, 112 S. Ct. 1925 (1992) (recognizing that, given the plain legislative intent underlying the unqualified refund scheme, it was both unnecessary and outside the judicial role to undertake a prospectivity analysis of *Davis*); *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *petition for cert. pending*, No. 91-375 (Sept. 3, 1991) (affirming the trial court's determination that the state refund remedy should be applied without regard to a prospectivity analysis of *Davis*); *Ragsdale v. Department of Revenue*, 312 Or. 529, 823 P.2d 971 (1992) (holding that the Oregon refund statutes require retroactivity even if *Davis* would otherwise apply only prospectively); *Pittsburgh & Midway Coal Mining Co. v. Arizona Dep't of Revenue*, 161 Ariz. 135, 776 P.2d 1061, 1065 (1989) (rejecting the notion that the outcome of a citizen's right to refund may be conditioned upon the relative clarity of the law at the time of payment of the tax in issue); *First Nat'l Bank v. Commonwealth*, 520 Pa. 244, 553 A.2d 937 (1989) (rejecting the prospectivity defense in light of the statutory refund right).

[18] *See, e.g.*, R. 27, 31, 33, 439-41.

[19] For example, as a matter of statutory law and settled administrative practice, individual refund claims stand on their own. There is no state statute or administrative rule that classifies refund claimants and conditions their right to a refund on a process that denies a claim because the aggregate of similar claims appears too high to a tax official. Similarly, the application of the prospectivity defense subjects these taxpayers to a threshold test not otherwise imposed on similarly situated taxpayers—the new principle of law-qualification.

2. The result reached by the Appellate Division discriminates based on the origin of the petitioners' claims. A state refund scheme that recognizes an unqualified refund right for claims based on state law but denies the right to taxpayers seeking to enforce constitutional rights is clearly unconstitutional. *See McKnett v. St. Louis & S.F.R. Co.*, 292 U.S. 230, 234, *reh'g denied*, 292 U.S. 613 (1934) ("A state may not discriminate against rights arising under federal laws."). *Cf. Hathorn v. Lovorn*, 457 U.S. 255, 263 (1982), *reh'g denied*, 458 U.S. 1131 (1982); *NAACP v. Alabama*, 357 U.S. 449, 457 (1958).[20]

3. The Constitution compels refunds in this case. The taxes collected by New York could "not be exacted," *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 387 (1960), in violation of the federal retirees' immunity and are therefore "void," *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752, *reh'g. denied*, 366 U.S. 947 (1961). The State has taken no steps to remedy the unlawful tax. As a matter of federal law, the State "had no choice but to 'undo' the unlawful deprivation by refunding the tax previously paid . . . ." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 39 (1990). "[T]o the extent [petitioners have] paid taxes pursuant to this invalid tax scheme, [they are] entitled to a refund." *See Davis*, 489 U.S. at 817; *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931).

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[20] The highest court of New York has categorically rejected financial hardship, even in the presence of a fiscal crisis, as a justification for denying a remedy for the violation of a right established by New York law. *See Flushing Nat'l Bank v. Municipal Assist. Corp.*, 40 N.Y.2d 731, 737, 390 N.Y.S.2d 22, 358 N.E.2d 848 (1976) ("It is elementary that denial of a remedy is a denial of the right.") (citations omitted); *Alliance of Am. Insurers v. Chu*, 77 N.Y.2d 573, 577, 569 N.Y.S.2d 364, 571 N.E.2d 672 (1991) ("The integrity of the State government, upon which the public is entitled to rely, requires, at the very least, that the State keep its lawfully enacted promises.").

III. THE DECISION BELOW CONFLICTS WITH THE COURT'S DECISIONS IN *HAFER*, *HOWLETT* AND *FELDER*.

1. With respect to petitioners' causes of action under 42 U.S.C. § 1983, neither the trial court nor the Appellate Division were "free to redefine the federal cause of action." *Howlett v. Rose*, 496 U.S. 356, 110 S. Ct. 2430, 2446 (1990). The Court has made clear that plaintiffs "may sue and obtain injunctive and declaratory relief" under § 1983 with respect to tax matters. *Dennis v. Higgins*, —— U.S. ——, 111 S. Ct. 865, 870 (1991). Accordingly, the Second Department's sole function in this case was to enforce 4 U.S.C. § 111 " 'according to its terms' ". *West Va. Univ. Hosp., Inc. v. Casey*, —— U.S. ——, 111 S. Ct. 1138, 1147 (1991) (citations omitted). The petitioners are entitled to a final and binding determination that the respondents may no longer enforce the illegal scheme. *See Ex parte Young*, 209 U.S. 123 (1908). *Cf. Quern v. Mandley*, 436 U.S. 725, 733-34 n.7 (1978).

2. With respect to petitioners' cause of action for damages against the named state and city officials, it was error for the courts below to have dismissed this claim. The respondents were directly involved in the enforcement of this unlawful scheme and have continued to deprive the petitioners of their rights to relief from this unlawful conduct. *See, e.g.*, R. 521-30. Contrary to the decision below, the respondents may be held individually liable under section 1983 for acts performed in the course of their official duties. *See Hafer v. Melo*, —— U.S. ——, 112 S. Ct. 358 (1991).[21]

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[21] To the extent that the Appellate Division's observation in dictum may be read to hold that the petitioners' claims for declaratory and injunctive relief under 42 U.S.C. § 1983 were alternatively subject to the affirmative defense of qualified immunity, the lower court's observation is erroneous. *See Ex parte Young*, 209 U.S. 123 (1908). With respect to petitioners' damage claims against the individually named city and state officials, the defense of quali-

3. It is well settled that "[t]he elements of, and the defenses to, a federal cause of action are defined by federal law." *Howlett*, 110 S. Ct. at 2442. Therefore, *inter alia*, under § 1983, the City of New York was liable for damages for the enforcement of its discriminatory scheme of taxation. *See Owen v. City of Independence*, 445 U.S. 622, 638, *reh'g denied*, 446 U.S. 993 (1980) ("But there is no tradition of immunity for municipal corporations, and neither history nor policy supports a construction of § 1983 that would justify . . . qualified immunity . . . ."). Accordingly, the Appellate Division decision "to redefine the federal cause of action," *Howlett*, 110 S. Ct. at 2446, was in direct contravention of its obligation under the Supremacy Clause.

4. In the proceedings below, the respondents strenuously opposed certification of the petitioner class with the attendant result that thousands of elderly citizens will each have to commence a separate review action to enforce their federal rights. However, as the Third Circuit has held in an analogous case under the Tax Injunction Act, "[w]here legal remedies require multiple suits involving identical issues against the same defendant, federal equity practice has recognized the inadequacy of the legal remedy and has provided a forum." *Garrett v. Bamford*, 538 F.2d 63, 71 (3d Cir.), *cert. denied*, 429 U.S. 977 (1976)

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fied immunity is unavailable. *See Tower v. Glover*, 467 U.S. 914, 920 (1984) (citations omitted) ("Section 1983 immunities are 'predicated upon a considered inquiry into the immunity historically accorded the relevant official at common law and the interests behind it.'"). In 1871, tax officials enjoyed no such immunity. *See, e.g., Osborn v. Bank of the United States*, 22 U.S. 738 (1824); *Erskine v. Van Arsdale*, 82 U.S. 75 (1872); *Atchison T. & S.F.R. Co. v. O'Connor*, 223 U.S. 280 (1912). Alternatively, qualified immunity is only properly asserted by officials exercising discretionary functions. *Westfall v. Erwin*, 484 U.S. 292 (1988). The respondents represented under oath to the trial court that they have acted without discretion. *See e.g.*, R. 381, 386. Consequently, the respondents cannot establish that they are entitled to assert the defense. *Tower*, 467 U.S. at 920-21; *Westfall*, 484 U.S. at 298 n.4.

(citations omitted). In *Garrett*, the Third Circuit held that "because the Pennsylvania procedure requires each person to bring a separate review action," *id.* at 71, "[a] denial of a federal forum in the instant case would allow a state to depend upon burdensome piecemeal review procedures as an effective defense to an allegedly unconstitutional tax structure." *Id.* at 72. The rigid approach of the respondents and of the court below under the "governmental operations rule" is designed to thwart rather than protect the federal rights of the putative class. It conditions the right to bring a § 1983 class suit "against the very persons and entities Congress intended to subject to liability." *Felder v. Casey*, 487 U.S. 131, 144-45 (1988). The authority of the court below did "not extend so far as to permit [the] State[] to place conditions on the vindication of a federal right." *Id.* at 147. "[T]he Supremacy Clause imposes on state courts a constitutional duty 'to proceed in such manner that all the substantial rights of the parties under controlling federal law [are] protected.'" *Id.* at 151 (citation omitted). Here, the court below was persuaded to follow a discretionary state rule, designed to insulate state officials from liability, in denying class certification.[22] However, "State courts simply are not free to vindicate the substantive interests underlying a state rule of decision at the expense of a federal right." *Id.* at 152.

The result reached by the decision below was designed to minimize governmental liability. Such a result in the instant case is "inconsistent in both purpose and effect with the remedial objectives of the federal civil rights law." *Id.* at 153. The decision of the court below to deny certification of this elderly putative class is contrary to the principles upon which the Court relied in pre-empting an analogous state notice of claim rule in

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[22] The prerequisites of Fed. R. Civ. P. 23, which are nearly identical to those found in CPLR 901(a)(1)-(4), all have been satisfied here. App. F at 62a.

Felder.[23] The respondents' outcome determinative rule "must give way" to the petitioners' federal rights. *Id.* at 151. *See also Garrett v. Bamford*, 538 F.2d at 72 ("[A] state [cannot] depend upon burdensome piecemeal review procedures as an effective defense to an allegedly unconstitutional tax structure.").

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari to the New York Supreme Court Appellate Division—Second Department—should be granted.

Respectfully submitted,

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September 22, 1992

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[23] With respect to this issue, the result of the decision below also conflicts with the *Davis*-related decisions in *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (Ark. 1991), *petition for cert. pending*, No. 91-375, and *Barker v. Kansas*, 815 P.2d 46 (Kan. 1991), *rev'd*, —— U.S. ——, 112 S. Ct. 1619 (1992). *Cf. Kuhn v. State, Dep't of Revenue*, 817 P.2d 101 (Colo. 1991), *cert. dismissed*, —— U.S. ——, 112 S. Ct. 1925 (1992).

APPENDICES

APPENDIX A

SUPREME COURT OF THE
STATE OF NEW YORK
APPELLATE DIVISION
SECOND JUDICIAL DEPARTMENT

Argued—May 21, 1991

WILLIAM C. THOMPSON, J.P.
JOSEPH J. KUNZEMAN
SONDRA MILLER
CORNELIUS J. O'BRIEN, JJ.

90-07800
91-02056
91-02059
91-02060
91-02061

EUGENE H. DUFFY, *et al.*,
Respondents-Appellants,

ALBERT ENGEL, *et al.*,
Proposed Plaintiffs-Intervenors-Appellants,

v.

JAMES W. WETZLER, ETC., *et al.*,
Appellants-Respondents.

OPINION & ORDER

APPEALS by the defendants James W. Wetzler, Roderick G.W. Chu, and Edward V. Regan, and by the defendants Anthony Shorris, Stanley E. Grayson, Abraham

Biderman, Paul Crotty, and the City of New York, in an action, *inter alia*, for declaratory and injunctive relief challenging the constitutionality of former Tax Law § 612(c)(3) and Administrative Code of the City of New York former § 11-1712(c)(3), from so much of an order and judgment (one paper) of the Supreme Court (Alan Le Vine, J.), dated June 14, 1990, and entered in Queens County, as declared the challenged laws invalid and unconstitutional, and enjoined the defendants from assessing or collecting personal income taxes which may still be due and owing, and from interfering with or refusing to grant the plaintiffs a refund of taxes paid on Federal pension benefits for the years 1986 through 1988, CROSS APPEAL by the plaintiffs from so much of the same order and judgment as, upon renewal, denied their motion for class certification, and dismissed the first cause of action asserted under 42 USC § 1983, and the fourth cause of action asserted against the defendant City of New York for money had and received (*Duffy v. Wetzler*, 148 Misc 2d 459), and APPEALS by the plaintiffs from four orders of the same court, all entered October 5, 1990, which denied their motions (i) for leave to renew or reargue their application for class certification and for resettlement of the judgment, (ii) to supplement their pleadings, (iii) to permit the intervention of various taxpayers, and (iv) for an award of attorneys' fees to plaintiffs' counsel under the common fund doctrine.

Robert Abrams, Attorney-General, Albany, N.Y. (Peter H. Schiff and Denise A. Hartman of counsel), for appellants-respondents James W. Wetzler and Roderick G.W. Chu, individually and as present or former New York State Commissioner of Taxation and Finance, and Edward V. Regan, individually and as Comptroller of the State of New York.

O. Peter Sherwood, Corporation Counsel, New York, N.Y. (Edward F.X. Hart, Stanley Buchsbaum, Frances J. Henn, and Edith I. Spivack of counsel), for appellants-

respondents Anthony Shorris, Stanley E. Grayson, Abraham Biderman, and Paul Crotty, individually and as present or former Commissioner of Finance of the City of New York, and the City of New York.

Anderson Kill Olick & Oshinsky, P.C., New York, N.Y. (Rudolph W. Giuliani, Mark L. Weyman, and Roberto Velez of counsel), Phelan & Costello, P.C., New York, N.Y. (John J. Phelan III, Robert J. Costello, and Michael F. Fitzgerald of counsel), and O'Neil, Cannon & Hollman, S.C., Milwaukee, Wisconsin (Eugene O. Duffy and Gregory W. Lyons of counsel), for respondents-appellants and proposed plaintiffs-intervenors-respondents-appellants. (one brief filed)

THOMPSON, J. P.

The main issue arising at bar is whether the decision in the instant case should be applied retroactively, or prospectively, pursuant to the recent decision of the United States Supreme Court in *James B. Beam Distilling Co. v. Georgia* (—— US ——, 111 S Ct 2439 [hereinafter Beam]). We conclude that an analysis of *Beam* requires prospective application on the facts. For the reasons which follow therefore, we modify the order and judgment from which the first appeal ensues, and affirm the orders appealed from.

I

The plaintiffs commenced this action on May 9, 1989, on behalf of themselves and purportedly all Federal retirees similarly situated, seeking a declaratory judgment, a permanent injunction, and damages as a result of the United States Supreme Court decision on March 28, 1989, in *Davis v Michigan Department of Treasury* (489 US 803 [hereinafter *Davis*]). In that case the Supreme Court invalidated, as unconstitutional, Michigan's tax scheme which exempted from taxation pensions paid to former State employees but taxed the pensions

paid to all other retirees, including those of the Federal government. *Davis' ratio decidendi* was predicated on a construction of 4 USC § 111, which provides, in pertinent part, that the Federal government consents to the taxation of its officers or employees "by a duly constituted taxing authority having jurisdiction, *if the taxation does not discriminate against the officer or employee because of the source of pay or compensation*" (emphasis added). The *Davis* court held that 4 USC § 111 applied to both retirement and ordinary income, and it found discrimination, and a violation of the principles of intergovernmental tax immunity in Michigan's exemption of State retiree pensions. While it will be more relevant later, it bears noting at this juncture that *Davis* never *decided* the point regarding prospectivity or retroactivity, and therefore made no determination as to refunds of those taxes which had been unconstitutionally assessed and collected.

Interestingly enough, at the time of the *Davis* decision, at least 19 states, including New York, had tax or pension statutes that included exemptions similar to Michigan's. Not surprisingly, *Davis* spawned a mass of litigation in many states on behalf of Federal retirees seeking, as do the plaintiffs at bar, an adjudication of the constitutionality of such statutes and/or refunds of taxes paid.

In 1920, both the Greater New York Charter and the New York Civil Service Law were amended to render exempt from State and municipal taxes the pensions of officers and employees of the State and City (*see*, L 1920, ch 427, ch 741). In 1939, a similar provision was incorporated into the New York Constitution as article XVI, § 5 which provides that "[a]ll salaries, wages and other compensation, *except pensions*, paid to officers and employees of the State and its subdivisions and agencies shall be subject to taxation" (emphasis added). This provision was also legislated into Tax Law § 612(c)(3),

one of the statutes at issue, "subtract[ing] from federal adjusted gross income * * * [p]ensions to officers and employees of this State." Also in 1939, in response to *Graves v People ex rel. O'Keefe* (306 US 466) and the Public Salary Tax Act of that year (4 USC § 111), New York first began to tax the compensation paid to Federal employees (*see*, L 1939, ch 619; codified as Tax Law § 359[6] and later repealed by L 1987, ch 267). For the first time in 1966, the City adopted a personal income tax containing an identical exemption for State and City pensions (*see*, New York City Administrative Code, § T46-112[c][3]; L 1966 ch 773, § 12[c]). In 1981, the State Legislature added a section to both the State and City personal income taxes which exempted from taxation pension benefits of all kinds up to the first $20,000 for any retirees over the age of 59½ (Tax Law § 612[c][3-a]; Administrative Code, § 11-1712[c][3-a]). At the crux of the instant action is the taxation of pension benefits of Federal retirees above this first $20,000, and of the total pension benefits of all Federal retirees under the age of 59½.

Soon after the *Davis* decision, and prior to this action, efforts were made to conform the State and City taxing schemes to *Davis*. On July 21, 1989, the Legislature amended Tax Law § 612(c)(3) and § 11-1712 of the Administrative Code to place pensions paid to Federal retirees in the same position as pensions of State retirees. The Legislature declared that the amendment was to take effect "immediately and shall apply to federal pension benefits received in taxable years beginning on or after January 1, 1989" (L 1989, ch 664, §§ 3; L 1989, ch 664, §§ 1, 2).

The plaintiffs' second amended complaint, served on December 23, 1989, set forth four causes of action. The first alleged a violation of 42 USC § 1983 and sought damages against the defendant Wetzler, the current Commissioner of Taxation and Finance of the State, and

various current and former functionaries in the State and City finance departments. The plaintiffs alleged that in enforcing the impugned Tax Law and Administrative Code, these defendants violated the plaintiffs' right guaranteed under 4 USC § 111 (principles of intergovernmental tax immunity), US Constitution, article VI, § 2, and the due process and equal protection clauses of the United States Constitution. The second cause of action sought a declaration that Tax Law § 612(c)(3) and New York City Administrative Code § 11-1712(c)(3) were unconstitutional. It also sought a refund for the years 1986 through 1989 and asked that those refund rights not be qualified by permitting only prospective application of the decision. In the third cause of action, the plaintiffs sought an injunction against the State and City defendants preventing them from collecting taxes on Federal pensions for the years 1986 through 1989, and et set up a trust fund for repayment of such allegedly unlawfully collected taxes. The fourth cause of action sought a refund from the City for money had and received. The second amended complaint also sought class certification and class attorneys' fees. After service of their answers, the State and City defendants moved for summary judgment on the ground that *Davis* applied prospectively only, since it was completely unforeseeable.

The Supreme Court (Le Vine, J.), *inter alia*, determined that the plaintiffs were entitled to refunds and enjoined the defendants from collecting the taxes as described therein for the period 1986 through 1988 (*Duffy v. Wetzler*, 148 Misc 2d 459). The court reasoned that the *Davis* decision mandated a declaration that "the City and State personal income tax scheme which taxed Federal pension benefits * * * while exempting State and local pension benefits, [was] discriminatory, invalid and unconstitutional" (*Duffy v Wezler*, *supra*, at 470). It observed that the 1989 amendments to the Tax Law and the Administrative Code were prospective only. "Thus, Federal Pension benefits received in years prior to 1989 re-

main[ed] subject to taxation and collection to the extent that the Statute of Limitation applie[d]" (*Duffy v Wetzler, supra*, at 465). The court found that there was no need to determine "whether *Davis* * * * should have prospective or retroactive application, as the question of entitlement, method and extent of a tax refund is governed by New York's Tax Law" (*Duffy v Wetzler, supra*, at 466). It referred to Tax Law § 687(a), which provided, in pertinent part, that a claim for a credit or an overpayment of income tax must be filed within the later of two periods, either three years from the date of filing of the return or two years from the date of payment of the tax. The court in *Duffy* found that although "overpayment" was not defined in the Tax Law, a reference to Federal income tax law, as well as Supreme Court decisions, yielded the conclusion "that overpayments arising out of the payment of a tax later held to be unconstitutional are recoverable in the same manner as other overpayments, provided that a timely claim is filed" (*Duffy v Wetzler, supra*, at 466). We disagree.

II

Central to the issue of tax refunds is the prior determination of the prospectivity versus retroactivity question. In our view, the court's opinion that a reference to Tax Law § 687(a) resolves the matter is a non sequitur, ignoring, as it does, the point, argued by the defendants, that there would be no "overpayment" if *Davis* is given prospective effect only. Moreover, none of the Supreme Court decisions cited by the court involved the issue of prospectivity/retroactivity (*see, e.g., Jones v Liberty Glass Co.*, 332 US 524; *Kavanagh v Noble*, 332 US 535). Hence, before a discussion of the proper construction of the term "overpayment" is reached, a determination of the prospectivity/retroactivity problem must be made. Prior to the recent decision of the United States Supreme Court in *Beam (supra)*, the leading case on this issue was *Chevron Oil Co. v Huson* (404 US 97). In that case, the

Supreme Court set forth, in the following language, the criteria for a prospective application of a decision:

> "First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied * * * or by deciding an issue of first impression whose resolution was not clearly foreshadowed * * * Second, it has been stressed that 'we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation' * * * Finally, we have weighed the inequity imposed by retroactive application, for '[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the "injustice or hardship" by a holding of nonretroactivity'" (*Chevron Oil Co. v. Huson, supra,* at 106-107).

An ancillary question at bar, therefore, is the extent to which the *Chevron Oil* case is still a valid precedent. For an answer to this, we turn to an analysis of *Beam.*

In *Beam,* the facts were that Georgia State law, prior to its amendment in 1985, had imposed an excise tax on imported alcohol and distilled spirits at a rate double that imposed on alcohol and distilled spirits manufactured from Georgia-grown products. In 1984, a Hawaii statute that similarly distinguished between imported and local alcoholic products was held, in *Bacchus Imports, Ltd. v. Dias* (468 US 263), to be violative of the Commerce Clause. Following *Bacchus,* the petitioner, a Delaware corporation and Kentucky bourbon manufacturer, claimed Georgia's law to be similarly inconsistent with the Commerce Clause and sought a refund of $2,400,000 representing the full amount of excise taxes paid for the years 1982, 1983, and 1984. The trial court and the Supreme Court of Georgia held that the pre-1985 version of the

statute violated the Commerce Clause but applied that finding on a prospective basis only, in the sense that it declined to declare the State's application of the statute unconstitutional for the years in question. The Georgia Supreme Court Court relied on *Chevron Oil Co. v Huson (supra)*, and concluded that, but for *Bacchus*, its decision on the constitutional question would have established a new rule of law by overruling past precedent.

The United States Supreme Court reversed and remitted the matter for further proceedings. The decision was, however, by plurality, with one main opinion delivered by Justice Souter (concurred in by Justice Stevens), three separate concurrences, and a dissent. Justice Souter's opinion commenced with the observation that "[s]ince the question is whether the court should apply the old rule or the new one, retroactivity is properly seen in the first instance as a matter of choice of law, 'a choice * * * between the principle of forward operation and that of relation backward'" (*James B. Beam Distilling Co. v Georgia*, —— US ——, 111 S Ct 2439, 2443, *supra*). Once a rule is found to apply retroactively there may then be a further issue of remedies, i.e., whether the party prevailing under a new rule should obtain the same relief that would have been awarded if the rule had been an old one. "Subject to possible constitutional thresholds * * * the remedial inquiry is one governed by state law, at least where the case originates in state court * * * But the antecedent choice-of-law question is a federal one where the rule at issue itself derives from federal law, constitutional or otherwise" (*James P. Beam Distilling Co. v Georgia, supra*, at 2443).

As enumerated in *Beam*, there were three ways in which the choice of law problem might be resolved. The first was full retroactivity, applying the decision both to the parties before the court and to all others similarly situated, consistent with res judicata and procedural barriers such as Statutes of Limitation. This practice is

"overwhelmingly the norm" but attracted the criticism that "[it] [fails] to take account of reliance on cases subsequently abandoned, a fact of life if not always one of jurisprudential recognition" (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2443). The second choice of law resolution was "the purely prospective method of overruling, under which a new rule is applied neither to the parties in the law-making decision nor to those others against or by whom it might be applied to conduct or events occurring before that decision. The case is decided under the old law but becomes a vehicle for announcing the new, effective with respect to all conduct occurring after the date of that decision" (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2443). This method, however, had the drawback that it tended to relax the force of precedent, by minimizing the costs of overruling and thereby allowing the courts to act with a freedom comparable to that of legislatures. The Justice noted that the court had, "albeit infrequently, restored to pure prospectivity" (*James B. Beam Distilling Co. v Georgia*, *supra* [*quoting Chevron Oil Co. v Huson*, 404 US 97]). Finally, the court might utilize "modified or selective, prospectivity," that is, it might apply a new rule to the case in which it was enunciated but return to the old rule with respect to all other cases arising on facts predating the decision (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2444). The weakness of selective prospectivity was its breach of "the principle that litigants in similar situations should be treated the same, a fundamental component of stare decisis and the rule of law generally" (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2444). Remarking that *Bacchus* had applied its own rule retroactively, Justice Souter held that it was error to refuse to apply a rule of Federal law retroactively after the case announcing the rule had already done so. He noted that "principles of equality and stare decisis here [prevailed] over any claim based on a *Chevron Oil* analysis" (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2446).

Justice Souter's opinion did not purport to overrule *Chevron Oil*. He noted that litigants could not be distinguished for choice-of-law purposes on the particular equities of their claims to prospectivity, that is, whether they actually relied on the old rule and how they would suffer from retroactive application of the new. He added that to that extent, the decision did limit the possible applications of the *Chevron Oil* analysis. "Because the rejection of modified prospectivity precludes retroactive application of a new rule to some litigants when it is not applied to others, the *Chevron Oil* test cannot determine the choice of law by relying on the equities of the particular case" (*James B. Beam Distilling Co. v. Georgia*, *supra*, at 2447). The Justice added that once retroactive application had been chosen for any assertedly new rule, it was chosen for all others who might seek its prospective application. "The applicability of rules of law are not to be switched on and off according to individual hardship" (*James B. Beam Distilling Co. v. Georgia*, *supra*, at 2448). In the final paragraphs of his opinion, Justice Souter noted that the grounds of the Court's decision were narrow, confined entirely to an issue of choice-of-law namely, "[w]hen the Court has applied a rule of law to the litigants in one case, it must do so with respect to all others not barred by procedural requirements or res judicata. *We do not speculate as to the bounds or propriety of pure prospectivity*" (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2448 [emphasis added]).

Justice White concurred with the retroactivity analysis. However, he departed from the main opinion by supporting *Chevron Oil*. He stated that retroactivity could be utilized either on the theory that the new decision was "reasonably foreseeable" and hence "not a new rule" (thus not implicating *Chevron Oil*) or on the view that the *Chevron Oil* factors would support a retroactive application (*James B. Beam Distilling Co. v Georgia*, *supra*, at 2448). He, however, perceived "no precedent in civil cases applying a new rule to the parties in the case but not to other

similarly situated" (that is, selective or modified prospectivity) (*James B. Beam Distilling Co. v Georgia, supra*, at 2448). The Justice, however, strongly supported the pure prospectivity theory. He said that "nothing in the above, however, is meant to suggest that I retreat from those opinions filed in this Court which I wrote or joined holding or recognizing that in proper cases a new rule announced by the Court will not be applied retroactively, even to the parties before the Court * * * [n]or, *without overruling Chevron Oil and those other cases before and after Chevron Oil*, holding that certain decisions will be applied prospectively only, can anyone sensibly insist on automatic retroactivity for any and all judicial decisions in the federal system * * * *The propriety of prospective application of decision in this Court, in both Constitutional and statutory cases, is settled by our prior decisions*" (*James B. Beam Distilling Co. v Georgia, supra*, at 2448-2449 [emphasis added]). Justice Scalia, with whom Justices Marshall and Blackmun joined, agreed "as an abstract matter" with Justice Souter's reasoning. However, he thought both selective prospectivity and pure prospectivity to be constitutionally impermissible since they infringed on the concept of "the judicial power as understood by our common law tradition" (*James B. Beam Distilling Co. v Georgia, supra*, at 2450). Justice Blackmun, with whom Justices Marshall and Scalia joined, thought "that prospectivity, whether 'selective' or 'pure' breaches our obligation to discharge our constitutional function" (*James B. Beam Distilling Co. v Georgia, supra*, at 2450).

The dissent (Justice O'Connor, joined by the Chief Justice and Justice Kennedy) criticized the majority's attempt to sidestep *Chevron Oil*, which "describes our long-established procedure for making this inquiry" (*James B. Beam Distilling Co. v Georgia, supra*, at 2451). Turning to Justice Souter's use of equality and stare decisis, Justice O'Connor observed that neither of these two concepts, without a consideration of *Chevron Oil*, led

to the view that once a decision was applied retroactively in the case at issue, it had to be applied retroactively to everyone. As to equality, *Chevron Oil's* purpose was to determine the equities of the case, and stare decisis cut exactly the other way by "allow[ing] those affected by the law to order their affairs without fear that the established law upon which they rely will suddenly be pulled out from under them" (*James B. Beam Distilling Co. v Georgia, supra,* at 2452). Justice Scalia concurred by stating that "imposition of retroactive liability on a litigant would *upset that litigant's settled expectations* because the earlier decision for which stare decisis effect is claimed * * * overruled prior law. That would turn the doctrine of stare decisis against the very purpose for which it exists" (*James B. Beam Distilling Co. v Georgia, supra,* at 2452). Utilizing a *Chevron Oil* analysis, Justice O'Connor concluded that the *Bacchus* case should not have been applied retroactively. It established a new rule ("*Bacchus*' rule * * * came out of the blue") (*James B. Beam Distilling Co. v Georgia, supra,* at 2455). And as regards the equities, the Justice stated that "the legitimate expectation of James Beam and other liquor manufacturers was that they had to pay the tax here at issue and that it was constitutional. They made their business decisions accordingly. There is little hardship to these companies from not receiving a tax refund they had no reason to anticipate" (*James B. Beam Distilling Co. v Georgia, supra,* at 2455). Finally, Justice O'Connor stated that the court had perverted the meaning of the terms "equality" and "stare decisis" on which it purported to base its retroactivity analysis (*James B. Beam Distilling Co. v Georgia, supra,* at 2450).

It goes without saying that *Beam* is not susceptible to easy explanation and requires the unsalutary procedure, as in all plurality decisions, of a judicial head-count. However, two points appear clear beyond equivocation. First, none of the opinions suggests that *Chevron Oil* has been overruled. Indeed, there appears to be a plurality

(Justices White, Stevens, Souter, and the three dissenters) who support pure prospectivity as enunciated in *Chevron Oil*. What separated the two camps was the issue whether or not it applied in *Beam* itself (Justices Marshall, Blackmun, and Scalia appear hostile to prospectivity in any form). Second, *Beam* is, as Justice Souter noted, a narrow decision, committed only to the removal of the doctrine of modified or selective prospectivity from this area of the doctrine of precedent ("when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata. We do not speculate as to the bounds or propriety of pure prospectivity" [*James B. Beam Distilling Co. v Georgia, supra*, at 2448]).

It is clear, therefore, that *Chevron Oil*, after *Beam*, continues to maintain its precedential vitality. It also bears noting that in two decisions, *Gager v White* (53 NY2d 475, 483-484), and *Matter of Jessica XX* (54 NY2d 417, 424, *affd sub nom. Lehr v Robertson*, 463 US 248), the Court of Appeals adopted a *Chevron Oil* analysis. Thus we do not agree with the proposition that "[t]he continued viability of the *Chevron* test is left in doubt by [*Beam*]" (*see, Kuhn v Colorado*, 817 P2d 101, 110 [Colo]).

III

In a proper case, *Beam* permits, or more precisely, does not proscribe a reference to the *Chevron Oil* criteria in determining whether a decision should have wholly prospective application. We hold that such an approach is mandated on the facts at bar and that the *Davis* decision fits the *Chevron Oil* criteria for prospective application.

Davis "establish[ed] a new principle of law * * * by deciding an issue of first impression whose resolution was not clearly foreshadowed" (*Chevron Oil Co. v Huson*, 404 US 97, 100, *supra*). The *Davis* decision was predicated on principles of intergovernmental tax immunity, de-

scribed as "a most esoteric of constitutional philosophies" (*see, Bohn v Waddell*, 164 Ariz 74, 790 P2d 772, 784, *adhered to on reconsideration*, 167 Ariz 344, 807 P2d 1). Indeed, the path from *McCulloch v Maryland* (4 Wheat 316), the *locus classicus* in this area, to *Davis* has been anything but a straight line (*see, Davis v Michigan Dept of Treasury*, 489 US 803, 810-815, *supra*, per Kennedy, J. for an historical exposition; *see also, Bohn v Waddell, supra*). Moreover, in *Davis*, Justice Stevens delivered a vigorous dissent based on the idea that "[o]nce one understands the underlying reason for the *McCulloch* holding, it is plain that this tax does not unconstitutionally discriminate against federal employees" (*Davis v Michigan Dept of Treasury, supra*, at 821). In language describing the novelty of this split decision, the Arizona Tax Court (Moroney, J.), in *Bohn v Waddell* (*supra*), observed that "[i]f justices of the United States Supreme Court cannot agree that the right defined in *Davis* was clearly established before *Davis*, it hardly seems appropriate to charge the individual [d]efendants in this case with such perspicacity" (*Bohn v Waddell, supra*, at 784).

Turning to the second criterion, nothing in the instant record demonstrates that retroactive application of *Davis* will either retard or further the doctrine of intergovernmental tax immunity. Since the primary purpose of that doctrine is to protect the Federal government, not private individuals, from being unduly burdened by State taxation (*see*, Senate Rep. No. 112, 76th Cong, 1st Sess 13, to accompany HR 3790), mandatory refunds to the plaintiffs would scarcely remove a threat to the efficient operation of the Federal Government. We also remain unpersuaded by the plaintiffs' contention that retroactive application will deter future enactment of illegal statutes. And as to the third *Chevron* criterion, we hold that the equities preponderate in the State's favor. New York State's taxing scheme, enacted in good faith and presumptively valid, was legitimate and in force for 50 years until a new rule was announced in *Davis*. In our view, the State

should not be required to refund an estimated $44,000,000, particularly in today's parlous fiscal circumstances, when neither the State nor the plaintiffs could reasonably have anticipated the invalidation of a longstanding tax provision. In sum, a *Chevron Oil* analysis mandates a prospective application of the instant decision. We would also note consistently with the *Beam* decision, that the *Davis* court never applied its own rule since Michigan "*conceded* that a refund [was] appropriate in these circumstances" (*Davis v Michigan Dept of Treasury, supra*, at 817) [emphasis added]; *see also, Pledger v Bosnick*, 306 Ark 45, 811 SW2d 286).

To the extent, therefore, that the Supreme Court's order and judgment in the case at bar awarded refunds and similar relief to the plaintiffs, we now modify that order and judgment by deleting those provisions.

IV

We agree, however, with the other conclusions indicated in the Supreme Court's judgment. First, the court properly denied the application for class action status. "It is well settled that class action certification is inappropriate in a case such as this where governmental actions are involved and subsequent plaintiffs will be adequately protected under the doctrine of stare decisis" (*Duffy v Wetzler*, 148 Misc 2d 459, 464, *supra, citing Matter of Crociate v State Tax Commn.*, 133 Misc 2d 855, *affd* 134 AD2d 112, *affd* 73 NY2d 726; *Conklin v Town of Southampton*, 141 AD2d 596). Nothing in the record at bar justifies a departure from this rule. Second, the court's rejection of the plaintiffs' claims under 42 U.S.C. § 1983 was correct. We add only the observation that the defense of qualified immunity, which the court did not reach (*see, Duffy v Wetzler*, 148 Misc 2d 459, 469, *supra*), provided a much simpler basis on which to reject the claims. In *Harlow v Fitzgerald* (457 US 800, 818 [emphasis added]), the United States Supreme Court set forth the parameters of qualified immunity, namely, "that government officials

performing discretionary functions, generally are shielded from liability for civil damages insofar as their conduct does not violate *clearly established statutory or constitutional rights* of which a reasonable person would have known" (*see also, Fox v Coughlin*, 893 F2d 475, 477-478; *Neal v Corcoran*, 869 F2d 662, 665, 667-669, *cert denied* 493 US 816; *Walentas v Lipper*, 862 F2d 414, 421-423, *cert denied* 490 US 1021). The claimed right under 4 USC § 111 was not "clearly established" until *Davis*, and so the individual defendants are "shielded from liability for civil damages."

We also agree with the court that, in an action for money had and received, an "appropriate legal protest prior to or at the time of payment [is] a prerequisite to recovery in an action seeking refunds" (*Duffy v Wetzler*, 148 Misc. 2d 459, 469-470, *supra*). The protest requirement was not satisfied at bar. Additionally, the court properly denied the plaintiffs' postjudgment motions seeking variously renewal or reargument of the denial of class certification, permission to add 16 new plaintiffs, intervention by other Federal retirees, and attorneys' fees under the common fund doctrine.

KUNZEMAN, MILLER and O'BRIEN, JJ., concur.

ORDERED that the order and judgment (one paper) of the Supreme Court, Queens County, dated June 14, 1990, is modified by deleting therefrom the provisions which (1) declared that the defendants may not assess and collect personal income taxes on Federal pension benefits received in the years 1986 through 1988 which may be still due and owing, (2) declared that the plaintiffs are entitled to a refund of that portion of their personal income taxes which was paid on Federal pension benefits for the years 1986 through 1988, (3) granted the plaintiffs' summary judgment on the third cause of action, and enjoined the defendants from collecting personal income taxes on Federal pension benefits from 1986 through 1988, and (4) enjoined the defendants from interfering with or

refusing to grant the plaintiffs a refund of personal income taxes paid on Federal pension benefits from 1986 through 1988; as so modified, the order and judgment is affirmed insofar as appealed and cross-appealed from, without costs or disbursements; and it is further,

ORDERED that the orders are affirmed insofar as appealed from, without costs or disbursements.

ENTER:

MARTIN H. BROWNSTEIN
Clerk

January 15, 1992

STATE OF NEW YORK)
) SS.:
COUNTY OF ALBANY)

Alvin Kershaw, being duly sworn, deposes and says:

I am over eighteen years of age and an employee in the office of Robert Abrams, Attorney General of the State of New York, attorney for the State Defendants, herein.

On the 23rd day of January, 1992, I served the annexed Opinion and Order upon the following individual/attorney named below, by depositing a true copy thereof, properly enclosed in a sealed, postpaid wrapper, in the letter box of the Capitol Station post office in the City of Albany, New York a depository under the exclusive care and custody of the United States Post Office Department, directed to the said individual/attorney at the addresses within the State respectively theretofore designated by them for that purpose as follows:

Hon. O. Peter Sherwood
Corporation Counsel of the
City of New York
100 Church St.
New York, NY 10007

Anderson Kill Olick
& Oshinsky, P.C.
666 Third Ave.
New York, NY 10017

Phelan & Costello, P.C.
One Penn Plaza, Suite 4310
New York, NY 10119

O'Neil, Cannon & Hollman, S.C.
111 East Wisconsin Ave., Suite 1400
Milwaukee, WI 53202

Sworn to before me this 23rd day of January, 1992.

/s/ Alvin Kershaw

/s/ William H. Collins
Notary Public

NEW YORK SUPREME COURT
APP. DIV.
SECOND DEPT.

90-07800, 91-02056, 91-02059, 91-02060, 91-02061

EUGENE H. DUFFY, *et al.*,
Respondents-Appellants,

ALBERT ENGEL, *et al.*,
Proposed Plaintiffs-Intervenors-Appellants

v.

JAMES W. WETZLER, ETC., *et al.*,
Appellants-Respondents.

OPINION AND ORDER

ROBERT ABRAMS
Attorney General of the
State of New York
Attorney for State Defendants

Sir/Madam:

Take notice that the within is a copy of the Opinion and Order duly filed and entered in the office of the Clerk of AD-2d Dept on the 15th day of Jan. 1992.

Yours, etc.,

ROBERT ABRAMS
Attorney General,

Attorney for State Defendants
The Capitol
Albany, NY 12224

TO:

Hon. O. Peter Sherwood
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JAN 27 1992

R Velez

NEW YORK SUPREME COURT
APPELLATE DIVISION
2ND DEPARTMENT

EUGENE H. DUFFY, *et al.*,
Respondents-Appellants,

ALBERT ENGEL, *et al.*,
Proposed Plaintiffs-Intervenors-Appellants,

v.

JAMES W. WETZLER, ETC., *et al.*,
Appellants-Respondents.

APPELLATE DIVISION
ORDER AND OPINION

O. PETER SHERWOOD
Corporation Counsel
Attorney for City Appellants
100 Church Street,
New York, N. Y. 10007

Due and timely service of a copy of the within Order and Notice of Entry is hereby admitted.

New York, ..., 19
Attorney for

.....

To

....., Esq.
Attorney for

PLEASE TAKE NOTICE, that an order, of which the within is a copy, was duly entered in the office of the Clerk of the Appellate Division of the Supreme Court in and for the Second Judicial Department on the 15th day of January, 1992.

Yours, etc.

O. PETER SHERWOOD
Corporation Counsel,
Attorney for City Appellants
100 Church Street,
New York, N. Y. 10007
Telephone: 788-1067

To:

See attached sheet ..... , Esq.,
Attorney for

APPENDIX B

SUPREME COURT,
QUEENS COUNTY
IA PART 7

By: LEVINE, J.

Index No. 7706/89

Dated: April 10, 1990

EUGENE H. DUFFY, *et al.*,

— against —

JAMES W. WETZLER, *et al.*

MEMORANDUM

In this action for declaratory, injunctive and monetary relief plaintiffs seek leave to renew and, upon renewal, certification of this action as a class action, and an order granting partial summary judgment on the second cause of action for declaratory judgment. Defendants Shorris, Grayson, Biderman, Crotty and the City of New York cross-move for an order granting summary judgment dismissing the complaint. Codefendants Wetzler, Chu and Regan cross-move for an order granting summary judgment dismissing the complaint.

This action was commenced as a result of the March 28, 1989 decision of the United States Supreme Court in *Davis v. Michigan Department of Treasury* (489 US —, 109 S Ct. 1500.) The Supreme Court held that Michi-

gan's tax scheme, which exempted from taxation all retirement benefits paid by the State or its political subdivisions, but levied an income tax on retirement benefits paid by all other employers, including the Federal Government violated federal law. The court therein determined that 4 USC § 111 which permits nondiscriminatory state taxation of the compensation of federal employees, applied to the retirement benefits of federal retirees, and that this statute is coextensive with, and must be determined by reference to, the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. The court therefore found that the Michigan statute violated the principles of intergovernmental tax immunity by favoring retired State and local governmental employees over retired Federal employees. In *Davis (supra)*, Michigan conceded that under these circumstances a refund was appropriate, and therefore the court determined that Mr. Davis was entitled to a refund. The court, however, made no determination as to whether its decision should be given retroactive effect, and whether the State must provide retrospective relief, such as a tax refund. Mr. Davis' additional claim for prospective relief was left for determination by the State court.

Prior to *Davis (supra)*, 24 states, including New York, had tax statutes similar to that of Michigan. In New York, pursuant to Article XVI, section 4 of the New York State Constitution pensions paid to officers and employees of the State are exempt from taxation. The pensions of all other employers, including the Federal Government were subject to taxation. In 1981, section 612(c)(3-a) was added to the Tax Law, exempting from income tax the first $20,000 in pension income received by retirees who attained the age of fifty-nine and one-half. Recipients of State and local government pensions, however, remained exempt from taxation pursuant to the State Constitution, and section 612(c)(3) of the Tax Law.

Following *Davis* (*supra*), section 612(c)(3) of the Tax Law was amended to exempt from taxation the pensions of federal employees. (Tax Law § 612[c][3][i], [ii].) This amendment became effective immediately on July 21, 1989 and applied to Federal pension benefits received in taxable years beginning January 1, 1989. Directives issued by the Department of Taxation and Finance provided that any person who may have made a quarterly tax payment during 1989 which was based on a calculation including a tax on a Federal pension would be entitled to a tax credit. The amendment to section 612(c)(3) of the Tax Law was prospective only, and made no provision for retrospective relief for income taxes paid on Federal pension benefits received prior to January 1, 1989. Section 612(c)(3-a) remains in effect, and is applicable to taxes which were paid or remain due and owing on Federal pension benefits which were received prior to January 1, 1989. The Administrative Code of the City of the New York, section 11-1712(c)(3) was amended in an identical fashion to exempt Federal pension benefits from taxation by the City of New York.

This action was commenced prior to the July 1989 amendments to the State Tax Law and the Administrative Code of the City of New York. A second amended complaint was served in December 1989. Plaintiffs Eugene H. Duffy, James Sweezy and Fernando S. Maura are former employees of the Federal Government and each receive Federal retirement benefits. Coplaintiffs Alice Duffy and Agnes Sweezy are the wives of Eugene Duffy and James Sweezy, respectively, and are named as plaintiffs herein solely as their status as joint tax return filers with their respective husbands. Mr. and Mrs. Duffy previously resided in Suffolk County and are currently residents of Queens County. Mr. Duffy is over the age of 59½ years and filed joint New York State income tax returns for the years 1986 through 1988. Mr. and Mrs. Sweezy are residents of Queens County and filed joint New York City and New York State income tax returns for the

years 1986 through 1988. Mr. Sweezy is also over the age of 59½ years. Mr. Maura is a resident of White Plains, New York, is under the age of 59½ years, and filed New York State income tax returns for 1986 through 1988. Plaintiffs commenced this action, individually and as representatives of all Federal pensioners similarly situated. Defendants James W. Wetzler, the present New York State Commissioner of Taxation and Finance, and former State Commissioner Roderick Chu, and Edward V. Regan, Comptroller of the State of New York (hereinafter "State defendants"), are being sued in their individual and official capacities. Codefendants Anthony Shorris, the present Commissioner of Finance of the City of New York, and former Commissioners Stanley E. Grayson, Abraham Biderman, and Paul Crotty (hereinafter "City defendants") are also being sued in their individual and official capacities. The City of New York is also named as a codefendant.

Plaintiffs assert that section 612(c)(3-a) of the Tax Law which imposes a State income tax on Federal pensions received prior to January 1, 1989, subject to a $20,000 deduction for receipients 59½ years old, is unconstitutional and illegal in light of *Davis* (*supra*). Plaintiffs' first cause of action for damages under 42 USC § 1983 alleges a civil right violation based on the City and State defendants' alleged refusal to recognize and grant plaintiffs' right to a refund of unlawfully collected taxes. It is alleged that the City and State defendants acted in their individual and official capacities, and plaintiffs seek damages "in the amount equal of all monies unlawfully paid to and/or collected" by defendants as New York City and State income taxes on their retirement benefits during the years 1986 to the present. Plaintiffs have made no demand on defendants for a declaration of invalidity and unconstitutionality and allege that this would be useless and futile.

Plaintiffs, in their second cause of action, seek a declaration to the effect that: (i) the taxing scheme imposed

by the State and City of New York prior to 1989 which imposed an income tax on their Federal pension benefits while exempting the pensions of State and local retirees, is invalid and unconstitutional under 4 USC § 111, Article VI, clause 2 of the United States Constitution, the Fourteenth Amendment to the United States Constitution, and principles of intergovernmental tax immunity; (ii) that plaintiffs are entitled to damages in the amount of all income taxes paid or collected from 1986 to the present on such benefits; (iii) that the further collection or enforcement of such income taxes attributable to any tax year prior to 1989 is invalid and unconstitutional; and (iv) refund rights granted to taxpayers for individual income taxes illegally collected may not be qualified by permitting such refunds only prospectively.

The third cause of action seeks injunctive relief against the further collection of the alleged unconstitutional tax imposed on Federal pensions for the years prior to 1989. The fourth cause of action is against defendant City of New York for money had and received.

Plaintiffs now seek leave to renew and, upon renewal, seek an order granting class certification pursuant to CPLR 901 and 902. Plaintiffs further seek an order granting summary judgment on the second cause of action for declaratory judgment. The City defendants and the City of New York, and the State defendants each cross-move for summary judgment dismissing the complaint in its entirety on the grounds that it fails to state a cause of action.

Plaintiffs' request for renewal is granted, as issue has now been joined and, upon renewal, the request for class certification is denied. Plaintiffs' reliance on post *Davis* (*supra*), class action litigation in sister states, as well as their attempts to distinguish *Brady v State of New York* (Supreme Court, Albany County, Prior J, August 23, 1989), and *Crociata v State Tax Commission* (133 Misc 2d 855, *affd* 134 AD2d 112, *affd* 73 NY2d 776), are un-

persuasive. It is well settled that class action certification is inappropriate in a case such as this where governmental actions are involved and subsequent plaintiffs will be adequately protected under the doctrine of stare decisis. (*Matter of Crociata v State Tax Commission, supra*; *Conklin v Town of Southampton*, 141 AD2d 596.) Plaintiffs have failed to demonstrate that this case presents an exception to this well established rule. Plaintiffs contend that class action is a superior method of adjudicating this controversy because the governmental entities cannot be trusted with the welfare of these Federal retirees. The court finds this argument unavailing. While the taxing authorities have taken the position that *Davis* (*supra*) does not apply retroactively and therefore does not require a tax refund, plaintiffs' assertion that the defendants will refuse to grant such refunds if so ordered is purely speculative.

Furthermore, while plaintiffs purportedly seek money damages pursuant to 42 USC § 1983, it is clear from the complaint that plaintiffs are in fact seeking a declaratory judgment, injunctive relief and a tax refund. Class action status, therefore, is inappropriate. A class action may not be used to protect members of the proposed class who paid the tax without registering a protest. Generally, a tax voluntarily paid may not be recovered. (*City of Rochester v Chiarella*, 65 NY2d 92, 99; *Mercury Mach. Importing Corp. v City of New York*, 3 NY2d 418, 425; *Adrico Realty Corp. v City of New York*, 250 NY2d.) In addition, non-protesting taxpayers may not enhance their tax refund claims through the use of a class action. (*Gandolfi v City of Yonkers, supra.*) Finally, it is clear that a claim for a tax refund is personal to the taxpayer. (*Gandolfi v City of Yonkers, supra*, at 198; *Conklin v Town of Southampton, supra.*) The court therefore, finds that the commencement of this action purportedly on behalf of all similarly situated taxpayers does not constitute an appropriate indication of protest by each proposed

member of the class. *Conklin v Town of Southampton, supra*, at 598-599.)

The *Davis* (*supra*) decision mandates that this court declare that the City and State personal income tax scheme, which taxed Federal pension benefits, while exempting State and local pension benefits, is discriminatory, unconstitutional and invalid. Contrary to defendants' assertions, the Legislature in enacting section 612(c)(3)(ii) of the Tax Law, and section 11-1712(c)(3) of the Administrative Code did not repeal or annul the former taxing provisions. These amendments are prospective only and exclude from taxation Federal pension benefits received on January 1, 1989 or later. Thus, Federal pension benefits received in years prior to 1989 remain subject to taxation and collection to the extent that the Statute of Limitations applies.

The Supreme Court in *Davis* (*supra*) did not announce whether its decision had retrospective or prospective application. In *Davis* (*supra*) Michigan conceded that the taxpayer was entitled to a refund and therefore the court made no further pronouncements on the issue of a refund. The Supreme Court in citing *Iowa-Des Moines Bank v Bennett* (284 US 239, 247), indicated that to the extent that the taxpayer paid taxes pursuant to an invalid tax scheme, he was entitled to a refund. Defendants, however, in view of this uncertainty argue that this court should apply the test announced in *Chevron Oil Co. v Huson* (404 US 97), and apply *Davis* prospectively only, thereby denying plaintiffs a refund.

The court finds that it need not determine whether *Davis* (*supra*) should have prospective or retroactive application, as the question of entitlement, method and extent of a tax refund is governed by New York's Tax Law. New York has waived its sovereign immunity to the extent provided by section 687(a) of the Tax Law, which provides in pertinent part:

> "Claim for credit or refund of an overpayment of an income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires the later * * *."

The term "overpayment" is not defined in the Tax Law. However, section 607(a) of the Tax Law provides that any term used in the Tax Law is deemed to have the same meaning as when used in a comparable tax of the Federal Income Tax Law. Thus, in construing section 6511 of the Internal Revenue Code, which is comparable to section 687 of the Tax Law, it has been held that overpayments arising out of the payment of a tax later held to be unconstitutional are recoverable in the same manner as other overpayments, provided that a timely claim is filed. (*Jones v Liberty Glass Co.*, 332 US 524, *reh denied* 333 US 850; *Kavenagh v Noble*, 332 US 524, *reh denied* 333 US 850; *Wisconsin National Life Ins. Co. v U.S.*, 42 F2d 316; *cf.*, *City of Rochester v Chiarella*, 65 NY2d 92; *Niagara Mohawk Power Corp. v City School District of the City of Troy*, 59 NY2d 262.)

Defendants assert that a tax refund is not mandated here, as the Court of Appeals has permitted municipalities to retain revenues collected under unconstitutional real property taxes and have given such statutes prospective application only. (*Hurd v City of Buffalo*, 41 AD2d 402, *affd* 34 NY2d 628; *Matter of Slewett and Farber v Board of Assessors of the County of Nassau*, 54 NY2d 547; *Bethlehem Steel v Board of Education*, 61 AD2d 147, *affd* 44 NY2d 836; *Matter of Hellerstein v Assessor of the Town of Islip*, 37 NY2d 1.) This line of cases, however, are clearly distinguishable from the case at bar. Each of these cases involved a challenge to real property tax assessment rolls used by the various localities pursuant to the Real Property Tax Law. The Court of Appeals in *Foss* (*supra*), *Hellerstein* (*supra*), and *Hurd* (*supra*) did not require refunds of improperly or over-assessed

property as this would have required the localities to reassess all of the property in those localities, equalize the assessments, locate the property owners and make the appropriate refunds or demands for the additional payment of taxes. Moreover, these localities depended upon the real property tax assessments to formulate and adopt a budget, and these revenues had already been spent.

In contrast, the case at bar involves the right to a refund of personal income taxes. This court has failed to discover a single reported case in which the courts of this State have refused to refund monies collected pursuant to a provision of the Tax Law or, more specifically, the personal income tax provisions of Article 22, which was later declared unconstitutional. Accordingly, the cases relied upon by defendants fail to provide a basis for a denial of a refund of personal income taxes paid under an unconstitutional taxing scheme. In addition, the obvious and substantial differences between real property taxes and personal income taxes militate against the application of this line of cases to income tax cases. Personal income taxes are paid into the general revenue and defendants do not claim that the State or City relied upon the taxation of Federal pension benefits in the formulation of their respective budgets. While the court is mindful of the current budgetary crisis facing the State and City, it is constrained to declare that if plaintiffs meet the procedural requirements, they are entitled to a refund to the extent they paid taxes on Federal pension benefits which were included in their personal income tax returns for the years 1986 through 1988.

Turning now to defendants' cross motions summary judgment, the request to dismiss the first cause of action for damages pursuant to 42 USC § 1983, is granted. Plaintiffs, in their complaint, allege that the City defendants, in their official and individual capacities, violated plaintiffs' rights under 4 USC § 111 and the Constitution, by subjecting them to a discriminatory tax scheme, and

by refusing to recognize and grant plaintiffs' clearly established right to a refund of the unlawfully collected taxes.

At the outset, the court notes that plaintiffs may not maintain an action for damages against the State of New York, or against the State defendants, in their official capacities, pursuant to 42 USC § 1983. (*Will v Michigan Dept. of State Police*, —— USC ——, 109 S Ct 2304.) Municipal entities and their officials, however, may be sued in their official and individual capacities. (*Monell v New York City Dept. of Social Services*, 436 US 658.)

The collection and administration of New York City's personal income tax, as well as refunds of such tax, was taken over by the State of New York in 1975. (Administrative Code of New York City §§ 11-1797[a], 11-1798.) The State Tax Commissioner is charged with the administration and enforcement of the City personal income tax, and all refunds of said tax are paid by the State Comptroller out of a reserve fund established for that purpose. Plaintiffs have failed to establish that the City of New York and the City defendants engaged in any conduct concerning the enforcement of the challenged tax scheme, the collection of taxes, or the right to a refund. The City defendants therefore may not be sued under § 1983 for functions which are performed by State tax officials. Plaintiffs' § 1983 claims against the City defendants and the City of New York are therefore dismissed.

The thrust of plaintiffs' § 1983 claims against the State defendants is that under State law, plaintiffs were required to pay personal income taxes on their Federal pensions benefits from 1986 through 1988. Plaintiffs allege that the State law violated 4 USC § 111 and the doctrine of intergovernmental tax immunity and that this should have been clear to the State defendants prior to *Davis*. Plaintiffs further assert that following *Davis*, the State defendants failed to grant plaintiffs a refund of those

taxes. Plaintiffs, however, have failed to establish that they paid the taxes in question due to any personal action taken against them by the State defendants. Rather, the taxes paid by plaintiffs were imposed by State law, and defendants Wetzler, Chu and Regan were not personally involved in the collection and assessment of plaintiffs' State personal income taxes. There has been no showing that any of the State defendants personally engaged in any activity in connection with the taxation of Federal pensions so as to give rise to a § 1983 claim. The fact that these defendants were or are in a high position of authority is an insufficient basis for the imposition of personal liability. (*McKinnon v Patterson*, 568 F2d 930, 934; *see generally, City of Canton, Ohio v Harris*, —— US ——, 109 S Ct 1197.)

In addition, the court notes that defendant Chu left the office of Commissioner of the Department of Taxation and Finance approximately nine months prior to the *Davis* decision. Thus, it is clear that defendant Chu was not involved in any decision regarding post *Davis* refunds. As this court has previously stated, *Davis* did not establish a clear right to retrospective relief, such as a tax refund. Moreover, in the absence of a refund demand by plaintiffs prior to the commencement of this action, no such refund could be certified by defendant Wetzler or issued by defendant Regan. Therefore, in the absence of a factual showing that the State defendants acting under color of State law participated individually in a civil rights violation, plaintiffs' § 1983 claim must be dismissed. (*Al-Jundi v Estate of Rockefeller*, 885 F2d 1060; *Williams v Smith*, 781 F2d 319, 323-324; *Taylor v Mayone*, 636 F2d 247.) In view of the foregoing this court need not reach plaintiffs' claims of due process and equal protection, or defendants' defenses of exhaustion of administrative remedies and qualified immunity.

That branch of defendants' cross motions which seek to dismiss plaintiffs' third cause of action for injunctive re-

lief is denied. Contrary to defendants' assertions, this cause of action is not moot, as New York's taxing scheme which taxes Federal pension benefits reveived prior to January 1, 1989 has not been annulled or repealed. In view of the fact that this court has declared this tax scheme to be invalid and unconstitutional, and has declared that plaintiffs may seek a refund of taxes paid on Federal pension benefits from 1986 through 1988, reverse summary judgment granting injunction relief is appropriate. The State defendants are therefore enjoined from assessing and collecting personal income taxes on Federal pension benefits which may be due and owing for the years 1986 through 1988, and are further enjoined from interfering with plaintiffs' right to file for a refund of personal income taxes paid on Federal benefits for the years 1986 through 1988.

Finally, that branch of defendant City of New York cross motion to dismiss plaintiffs' fourth cause of action for money had and received is granted. An action for money had and received may be used to recover taxes which have been collected in violation of constitutional authority. (*Matter of Trezec v City of New York*, 66 NY2d 807.) However, it is incumbent upon the taxpayer to establish appropriate legal protest prior to or at the time of payment as a prerequisite to recovery in an action seeking refunds. (*See, City of Rochester v Chiarella*, 58 NY2d 316; *Zuckerman v City of New York*, 49 NY2d 415; *Angeline v City of Rochester*, 72 AD2d 445, *affd* 52 NY2d 982; *Bethlehem Steel Corp. v Board of Educ.*, 61 AD2d 147, *affd* 44 NY2d 831.) While the commencement of a declaratory judgment action to challenge an assessment under a tax statute may constitute sufficient protest, ordinarily protest must be made at the time of payment for each year in which recovery is sought. (*See, City of Rochester v Chiarella, supra*; *Riverdale Country School v City of New York*, 13 AD2d 103, *affd* 11 NY2d 741.) This requirement is also satisfied when the pendency of either a declaratory judgment action

or other legal proceeding challenging the assessment is still pending at the time of payment in each year in which recovery is sought. (*Corporate Properties Investors v Board of Assessors of the County of Nassau*, —— AD2d ——, 545 NYS2d 166, 170.) In the case at bar, plaintiffs have failed to establish compliance with the protest requirement. No protest was made by plaintiffs at the time they paid personal income taxes on Federal pension benefits received in the years 1983 through 1988. Furthermore, the within action was not commenced until May 8, 1989 which was after plaintiffs paid personal income taxes due on April 17, 1989, for Federal pension benefits received in 1988. Therefore, no action was pending at the time of payment for the years in which recovery is now sought.

In view of the foregoing, plaintiffs' motion for renewal is granted, and upon renewal, the request for class certification is denied. That branch of plaintiffs' motion which seeks partial summary judgment on the second cause of action for declaratory judgment is granted, and it is the declaration of this court that:

(1) The City and State personal income tax scheme which taxed Federal pension benefits received prior to January 1, 1989, while exempting from taxation State and local pension benefits, is discriminatory, invalid and unconstitutional in light of *Davis* (*supra*);

(2) The City and State defendants therefore may not assess and collect personal income taxes on Federal pension benefits received in the years 1986 through 1988, which may be still due and owing;

(3) Plaintiffs are entitled to a refund of that portion of their personal income taxes which was paid on Federal pension benefits for the years 1986 through 1988, provided that they file for a refund and meet the procedural requirements for a refund under the Tax Law.

The City defendants' and the City of New York's cross motion to dismiss the complaint is granted as to the first

and fourth causes of action, and is denied as to the third cause of action. The State defendants' cross motion to dismiss the complaint is also granted as to the first cause of action and is denied as to the third cause of action. Reverse summary judgment in favor of the plaintiffs is granted on the third cause of action, and the City and State defendants are enjoined from assessing and collecting personal income taxes on Federal pension benefits for the years 1986 through 1988, which may still be due and owing. Defendants are further enjoined from interfering with or refusing to grant plaintiffs a refund of personal income taxes paid on Federal pension benefits for the years 1986 through 1988, provided that plaintiffs meet all the procedural requirements for a refund under the Tax Law. Finally, defendants' requests for sanctions is denied.

Settle order.

_____

J.S.C.

APPENDIX C

At an IAS Part 7 of the Supreme Court, State of New York, County of Queens, at the Queens County Courthouse, 120-55 Queens Boulevard, Kew Gardens, New York, on the 14th day of June, 1990.

PRESENT: HON. ALAN LEVINE, Justice.

Index No. 7706/89

EUGENE H. DUFFY, ALICE G. DUFFY, JAMES SWEEZY, AGNES SWEEZY and FERNANDO S. MAURA, on behalf of themselves and all residents of the State of New York who were paid retirement benefits by the United States Government and who paid and/or are subject to New York State and/or New York City Income Taxes thereon in any one or all of the years during the period 1986 through the present, similarly situated,

Plaintiffs,

-against-

JAMES W. WETZLER and RODERICK G.W. CHU, individually and as present or former NEW YORK STATE COMMISSIONER OF TAXATION AND FINANCE, EDWARD V. REGAN, individually and as COMPTROLLER OF THE STATE OF NEW YORK, ANTHONY SHORRIS, STANLEY G. GRAYSON, ABRAHAM BIDERMAN and PAUL CROTTY, individually and as present or former COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK, and THE CITY OF NEW YORK,

Defendants.

ORDER AND JUDGMENT

The plaintiffs having commenced this action for declaratory, injunctive and monetary relief challenging the validity and constitutionality of New York Tax Law § 612(c)(3) and Administrative Code of the City of New York § 11-1712(c)(3) in imposing personal income tax on certain pension income of retired federal employees who attained the age of fifty-nine and one-half, while the pension benefits of state and local government retirees remain exempt from taxation pursuant to the State Constitution, and the plaintiffs having moved for partial summary judgment for declaratory relief pursuant to CPLR 3212(e) and 42 U.S.C. § 1983, and for renewal of their prior motion for class certification pursuant to Article 9, CPLR, and the defendants having cross-moved for summary judgment dismissing the complaint and for sanctions;

NOW, upon reading and filing the copy of the second amended summons and the copy of the verified complaint verified December 13, 1989; the verified answer of defendants Shorris, Grayson, Biderman, Crotty and the City of New York to the second amended complaint verified January 9, 1990; the verified answer of defendants Wetzler, Chu and Regan to the second verified complaint verified January 5, 1990; the notice of motion of plaintiffs dated January 10, 1990, seeking an order and judgment granting partial summary judgment to plaintiffs, granting leave to renew their motion for class certification and, upon renewal, certifying this action as a class action; the affirmation of John J. Phelan, III, dated January 10, 1990, in support thereof; the affirmation of Michael F. Fitzgerald, dated January 10, 1990, in support thereof and the exhibits and documents annexed thereto; and the copy of the affidavit of Howard J. Sample, sworn to June 13, 1989, in support thereof; the notice of cross-motion dated January 17, 1990, by defendants Wetzler, Chu and Regan seeking an order and judgment summary

judgment dismissing the complaint herein and imposing sanctions against plaintiffs; the affirmation of August L. Fietkau, dated January 17, 1990, in support of the cross-motion and in opposition to the plaintiffs' motion; the affidavit of Roderick G.W. Chu, sworn to January 12, 1990, in opposition to the plaintiffs' motion and in support of the cross-motion; the affidavit of William F. Collins, sworn to January 12, 1990, in opposition to the plaintiffs' motion and in support of the cross-motion; the affirmation of George H. Weissman, dated January 16, 1990, in opposition to the plaintiffs' motion and in support of the cross-motion and the exhibits and documents annexed thereto; the notice of cross-motion dated January 17, 1990 by defendants Shorris, Grayson, Biderman, Crotty and the City of New York seeking an order and judgment granting summary judgment dismissing the complaint and imposing sanctions; and the affirmation of Frances J. Henn dated January 17, 1990, in opposition to plaintiffs' motions and in support of the cross-motion and the exhibits and documents annexed thereto; the reply affirmation of Michael F. Fitzgerald dated February 7, 1990, in support of plaintiffs' motion and in opposition to the cross-motions; and the affidavit of Walter Hellerstein, sworn to February 5, 1990, in support of plaintiffs' motion and in opposition to the cross-motions and the exhibits and documents annexed thereto; the reply affirmation of August L. Fietkau, dated February 14, 1990, in opposition to the plaintiffs' motion and in support of the cross-motions, and the exhibit annexed thereto; the reply affirmations of Eugene O. Duffy, affirmed February 5, 1990 and February 6, 1990, and the exhibits and documents annexed thereto; the affidavit of plaintiff, Eugene H. Duffy, sworn to February 19, 1990 in support of plaintiffs' motions and in opposition to the cross-motions; the sur-reply affirmation of Michael F. Fitzgerald dated February 26, 1990, and the copy of the sur-reply affirmation of Eugene H. Duffy dated February 22, 1990, in support of the plaintiffs' motion and in opposition to the cross-motions;

AND the motion and cross-motions having come on to be heard before the court, and Phelan & Costello (John J. Phelan, Esq., of counsel), having appeared as attorneys for plaintiffs; and Robert Abrams, Attorney General of the State of New York (August L. Fietkau, Assistant Attorney General, of counsel), having appeared as attorney for defendants Wetzler, Chu and Regan, and Victor Kovner, New York City Corporation Counsel (Frances Henn, Assistant Corporation Counsel, of counsel), having appeared for defendants Shorris, Grayson, Biderman, Crotty and City of New York; and the motion and cross-motions having been submitted at such time; and due consideration having been had thereon and the Court having rendered a memorandum decision dated April 10, 1990;

NOW, on motion of Robert Abrams, Attorney General of the State of New York, attorney for defendants Wetzler, Chu and Regan, and of Victor Kovner, New York City Corporation Counsel, attorney for defendants Shorris, Grayson, Biderman, Crotty and City of New York, it is hereby

ORDERED AND ADJUDGED that that portion of plaintiffs' motion which seeks renewal of their prior application for class certification is granted, and upon renewal, the request for class certification is denied; and it is further

ORDERED, ADJUDGED AND DECREED that the City defendants and the City of New York's cross-motion for summary judgment dismissing the complaint is granted as to the first cause of action, under 42 U.S.C. § 1983, and the fourth cause of action, for monies had and received, and is denied as to the third cause of action, for injunctive relief; and it is further

ORDERED, ADJUDGED AND DECREED that the State defendants' cross-motion for summary judgment dismissing the complaint is also granted as to the first

cause of action, under 42 U.S.C. § 1983, and is denied as to the third cause of action, for injunctive relief; and it is further

ORDERED, ADJUDGED AND DECREED that that branch of the defendants' cross-motions for sanctions is denied; and it is further

ORDERED, ADJUDGED AND DECREED that that branch of plaintiffs' motion which seeks partial summary judgment on the second cause of action for declaratory judgment is granted, and it is the declaration of this court that:

(1) the City and State personal income tax scheme which taxed federal pension benefits received prior to January 1, 1989, while exempting from taxation state and local pension benefits, is discriminatory, invalid and unconstitutional in light of *Davis v. Michigan Department of Treasury*, 489 U.S. ——, 109 S. Ct. 1500 (1990); and

(2) the City and State defendants therefore may not assess and collect personal income taxes on federal pension benefits received in the years 1986 through 1988, which may be still due and owing; and

(3) plaintiffs are entitled to a refund of that portion of their personal income taxes which was paid on federal pension benefits for the years 1986 through 1988, provided that they file for a refund and meet the procedural requirements for a refund under the tax law;

and it is further

ORDERED, ADJUDGED AND DECREED that summary judgment in favor of the plaintiffs is granted on the third cause of action, for injunctive relief, and the City and State defendants are enjoined from assessing and collecting personal income taxes on federal pension benefits for the years 1986 through 1988, which may still be due and owing; and it is further

ORDERED, ADJUDGED AND DECREED that the defendants are enjoined from interfering with or refusing to grant plaintiffs a refund of personal income taxes paid on federal pension benefits for the years 1986 through 1988, provided that plaintiffs meet all the procedural requirements for, and establish entitlement to, a refund under the tax law.

ENTER

/s/ AZ
J.S.C.
John J. Durante
Clerk

SUPREME COURT
STATE OF NEW YORK
COUNTY OF QUEENS

Index No. 7706/89

IAS Part 7

HON. ALAN LEVINE

EUGENE H. DUFFY, ALICE G. DUFFY, JAMES SWEEZY, AGNES SWEEZY and FERNANDO S. MAURA, on behalf of themselves and all residents of the State of New York who were paid retirement benefits by the United States Government and who paid and/or are subject to New York State and/or New York City Income Taxes thereon in any one or all of the years during the period 1986 through the present, similarly situated,

Plaintiffs,

-against-

JAMES W. WETZLER and RODERICK G.W. CHU, individually and as present or former NEW YORK STATE COMMISSIONER OF TAXATION AND FINANCE, EDWARD V. REGAN, individually and as COMPTROLLER OF THE STATE OF NEW YORK, ANTHONY SHORRIS, STANLEY E. GRAYSON, ABRAHAM BIDERMAN and PAUL CROTTY, individually and as present or former COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK, and THE CITY OF NEW YORK,

Defendants.

NOTICE OF ENTRY

SIRS:

PLEASE TAKE NOTICE that within is a true copy of an Order and Judgment duly entered in the office of the clerk of the within named court on July 26, 1990.

Dated: New York, New York
August 6, 1990

Yours, etc.

PHELAN & COSTELLO, P.C.
Attorneys for Plaintiffs
One Penn Plaza
New York, NY 10119
(212) 868-3000

SUPREME COURT OF THE
STATE OF NEW YORK
COUNTY OF QUEENS

Index No. 7706/89

IAS Part 7

HON. ALAN LEVINE

EUGENE H. DUFFY, *et al.*,
Plaintiffs,

- against -

JAMES W. WETZLER, *et al.*,
Defendants.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

Eileen K. O'Keefe being duly sworn, deposes and says:

1. I am not a party to the within action, am over 18 years of age and reside at New York, New York.

2. On August 6, 1990, I served true copies of the within Order and Judgment With Notice of Entry by depositing a true copy thereof enclosed in a post-paid wrapper, in an official depository under the exclusive care and custody of the U.S. Postal Service within New York State to the following at the last known address:

August L. Fietkau, Esq.
Assistant Attorney General
New York State Department of Law
120 Broadway
New York, New York 10271
(212) 341-2000
Attorneys for State Defendants

Frances Henn
Assistant Corporation Counsel
New York City Law Department
100 Church Street
New York, New York 10007
(212) 566-1330
Attorneys for City and Defendants

/s/ Eileen K. O'Keefe
EILEEN K. O'KEEFE

Sworn to before me this 7th day of August, 1990.

/s/ Michael E. Silverman
Notary Public

SUPREME COURT OF THE
STATE OF NEW YORK
COUNTY OF QUEENS

Index No. 7706/89

EUGENE H. DUFFY, *et al.*,
Plaintiffs,

- against -

JAMES W. WETZLER, *et al.*,
Defendants.

ORDER AND JUDGMENT
WITH
NOTICE OF ENTRY

PHELAN & COSTELLO, P.C.
Attorneys for

Office and Post Office Address, Telephone
One Penn Plaza
Suite 4310
New York, New York 10119

To

Attorney(s) for

Service of a copy of the within

is hereby admitted.

Dated,

.....

Attorney(s) for

Sir: Please take notice that the within is a (*certified*) true copy of an Order & Judgment duly entered in the office of the clerk of the within named court on June 26, 1990.

Dated,

Yours, etc.

PHELAN & COSTELLO, P.C.
Attorneys for Plaintiff

Office and Post Office Address
One Penn Plaza
Suite 4310
New York, New York 10119

To U.S. Attorney General
U.S. Corporation Counsel

Attorney(s) for

NOTICE OF SETTLEMENT

Sir: Please take notice that an order of which the within is a true copy will be presented for settlement to the Hon. one of the judges of the within named court at on 19

Yours, etc.

Dated,

PHELAN & COSTELLO, P.C.
Attorneys for

Office and Post Office Address
One Penn Plaza
Suite 4310
New York, New York 10119

To

Attorney(s) for

APPENDIX D

STATE OF NEW YORK
COURT OF APPEALS

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the seventh day of April A.D. 1992.

Present, HON. SOL WACHTLER, Chief Judge, presiding.

Mo. No. 376 SSD 31

EUGENE H. DUFFY, *et al.*,
Appellants,

ALBERT ENGEL, *et al.*,
Proposed Intervenors-Appellants,

v.

JAMES W. WETZLER, *et al.*,
Respondents.

The appellants and proposed intervenors-appellants having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal from so much of the Appellate Division order as affirmed Supreme Court's orders denying plaintiffs' post-judgment motions to renew or reargue the denial of class certification, for permission to add intervenors, and to supplement plaintiffs' pleadings, be and the same hereby is dismissed without costs, by the Court *sua sponte*, upon the ground that that portion of

the order appealed from does not finally determine the action within the meaning of the Constitution; and it is

ORDERED, that the appeal otherwise be and the same hereby is dismissed without costs, by the Court *sua sponte*, upon the ground that no substantial constitutional question is directly involved.

Judge Simons took no part.

/s/ Donald M. Sheraw
DONALD M. SHERAW
Clerk of the Court

STATE OF NEW YORK
COURT OF APPEALS

EUGENE H. DUFFY, *et al.*,
Appellants,

ALBERT ENGEL, *et al.*,
Proposed Intervenors-Appellants,

- against -

JAMES W. WETZLER, *et al.*,
Respondents.

ORDER

ROBERT ABRAMS
Attorney General of the
State of New York
Attorney for Respondents

Service of a copy of
within ..... is admitted
this ..... day of ..... 19.....

Sir/Madam:

Take notice that the within is a copy of the Order duly filed and entered in the office of the Clerk of Court of Appeals on the 7th day of April 1992.

Yours, etc.,

ROBERT ABRAMS
Attorney General,
Attorney for Respondents
The Capitol
Albany, NY 12224

STATE OF NEW YORK
DEPARTMENT OF LAW
THE CAPITOL
ALBANY, NY 12224

122 PM #12 04/30/92

Anderson Kill Olick
& Oshinsky, P.C.
666 Third Avenue
New York, New York 10017

R-Velez

COURT OF APPEALS
STATE OF NEW YORK

EUGENE H. DUFFY, *et al.*,
Appellants,
ALBERT ENGEL, *et al.*,
Proposed Intervenors-Appellants,

v.

JAMES W. WETZLER, *et al.*,
Respondents.

ORDER OF
COURT OF APPEALS

O. PETER SHERWOOD
Corporation Counsel
Attorney for Respondent City of New York
100 Church Street,
New York, N.Y. 10007
Tel: (212) 788-0842

Due and timely service of a copy of the within Judgment and Notice of Entry is hereby admitted.

New York, ..., 199

....., Esq.

Attorney for .....

PLEASE TAKE NOTICE that an Order, of which the within is a copy, was duly entered and filed in the office of the Clerk of the Court of Appeals on April 7, 1992.

Dated: New York, N.Y.

....., 199

O. PETER SHERWOOD
Corporation Counsel
Attorney for Respondent City of New York
100 Church Street,
New York, N.Y. 10007
Tel: (212) 788-0842

To:

Anderson, Kill, Olick & Oshinsky, P.C., Attorney for Appellants

The NYC Law Department File Number for this matter is ..

It is assigned to Frances Henn, Esq., Tax & Bankruptcy Division, (212) 788-0842.

Your reference to the above File Number on all documents and correspondence would be appreciated.

THE CITY OF NEW YORK
LAW DEPARTMENT
100 CHURCH STREET
NEW YORK, N. Y. 10007

TAX AND BANKRUPTCY

Anderson Kill Olick
& Oshinsky, P.C.
666 Third Avenue
New York, New York 10017

R-Velez

57a

FOR POLICE EMERGENCY ONLY

DIAL 911

APPENDIX E

STATE OF NEW YORK
COURT OF APPEALS

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the seventh day of July A.D. 1992.

Present, HON. SOL WACHTLER, Chief Judge, presiding.

2-14 Mo. No. 570

EUGENE H. DUFFY, *et al.*,
Appellants,

ALBERT ENGEL, *et al.*,
Proposed Intervenors-Appellants,

v.

JAMES W. WETZLER, *et al.*,
Respondents.

A motion for leave to appeal to the Court of Appeals in the above cause having heretofore been made upon the part of the appellants and proposed intervenors-appellants herein and papers having been submitted thereon and due deliberation having been thereupon had, it is

ORDERED, that the said motion for leave to appeal from so much of the Appellate Division order as affirmed Supreme Court's order denying plaintiffs' post-judgment motion to renew or reargue the denial of class certification be and the same hereby is dismissed upon the ground that that portion of the order sought to be ap-

pealed from does not finally determine the action within the meaning of the Constitution; and it is

ORDERED, that the said motion for leave to appeal otherwise be and the same hereby is denied.

/s/ Stuart M. Cohen
STUART M. COHEN
Deputy Clerk of the Court

APPENDIX F

EXCERPTS OF RELEVANT NEW YORK LAW

§ 607. Meaning of Terms

(a) General. Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute. Any reference in this article to the laws of the United States shall mean the provisions of the internal revenue code of nineteen hundred eighty-six (unless a reference to the internal revenue code of nineteen hundred fifty-four is clearly intended), and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time for the taxable year.

§ 687. Limitations on Credit or Refund

(a) General.—Claim for credit or refund of an overpayment of income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed, within two years from the time the tax was paid. If the claim is filed within the three year period, the amount of the credit or refund shall not exceed the portion of the tax paid within the three years immediately preceding the filing of the claim plus the period of any extension of time for filing the return unless such claim is for a credit or a portion thereof pursuant to subsection (e) of section six hundred six of this chapter. If the claim is not filed within the three year period, but is filed within the two year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim unless such claim is for a credit or a portion thereof

provided pursuant to subsection (e) of section six hundred six of this chapter. Except as otherwise provided in this section, if no claim is filed, the amount of a credit or refund shall not exceed the amount which would be allowable if a claim had been filed on the date the credit or refund is allowed.

PRE-1989 DISCRIMINATORY SCHEME

The N.Y.S. Tax Law 612(c)(3) provides as follows:

> (c) Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:
>
> (3) Pensions to officers and employees of this state, its subdivisions and agencies, to the extent includible in gross income for federal income tax purposes;

N.Y. Tax Law § 612(c)(3) (McKinney 1987 & Supp. 1990)*

The New York City Administrative Code § 11-1712(c)(3) provides as follows:

> (c) Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:
>
> (3) Pensions to officers and employees of this state, its subdivisions and agencies, to the extent includable in gross income for federal income tax purposes;

New York, N.Y., Administrative Code § 11-1712(c)(3) (1986 & Supp. 1990).*

---

* On July 21, 1989, the Legislature of the State of New York amended N.Y. Tax Law 612(c)(3) and New York City Administrative Code § 11-1712(c)(3) by removing the unconstitutional provision that discriminated against federal retirees. The amendments apply to federal pension income received in taxable years beginning January 1, 1989.

§ 901. Prerequisites to a class action.

a. One or more members of a class may sue or be sued as representative parties on behalf of all if:

1. the class is so numerous that joinder of all members, whether otherwise required or permitted, is impracticable;

2. there are questions of law or fact common to the class which predominate over any questions affecting only individual members;

3. the claims or defenses of the representative parties are typical of the claims or defenses of the class;

4. the representative parties will fairly and adequately protect the interest of the class; and

5. a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

* * * *

§ 5514. Extension of time to take appeal or to move for permission to appeal.

(a) Alternate method of appeal. If an appeal is taken or a motion for permission to appeal is made and such appeal is dismissed or motion is denied and, except for time limitations in section 5513, some other method of taking an appeal or of seeking permission to appeal is available, the time limited for such other method shall be computed from the dismissal or denial unless the court to which the appeal is sought to be taken orders otherwise.

* * * *

§ 5601. Appeals to the court of appeals as of right.

* * * *

(b) Constitutional grounds. An appeal may be taken to the court of appeals as of right:

1. from an order of the appellate division which finally determines an action where there is directly in-

volved the construction of the constitution of the state or of the United States; . . .

* * * *

§ 5602. Appeals to the court of appeals by permission.

(a) Permission of appellate division or court of appeals. An appeal may be taken to the court of appeals by permission of the appellate division granted before application to the court of appeals, or by permission of the court of appeals upon refusal by the appellate division or upon direct application. Permission by an appellate division for leave to appeal shall be pursuant to rules authorized by that appellate division. Permission by the court of appeals for leave to appeal shall be pursuant to rules authorized by the court which shall provide that leave to appeal be granted upon the approval of two judges of the court of appeals. Such appeal may be taken:

1. in an action originating in the supreme court, a county court, a surrogate's court, the family court, the court of claims, an administrative agency or an arbitration,

(i) from an order of the appellate division which finally determines the action and which is not appealable as of right, . . .

* * * *

APPENDIX G

PUBLIC SALARY TAX ACT OF 1939

AN ACT

Relating to the taxation of the compensation of public officers and employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Salary Tax Act of 1939."

TITLE I

SECTION 1. Section 22(a) of the Internal Revenue Code (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

SEC. 2. Section 116(b) of the Internal Revenue Code (exempting compensation of teachers in Alaska and Hawaii from income tax) is repealed.

SEC. 3. Section 22(a) of the Internal Revenue Code is amended by adding at the end thereof a new sentence to read as follows: "In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income".

SEC. 4. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession of political subdivision thereof, the District of Columbia, or any agency or

instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

TITLE II

SEC. 201. Any amount of income tax (including interest, additions-to-tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an assessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 19, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

SEC. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

SEC. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and

the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of such claim would result in the application of the doctrines in the cases of Helvering against Therrell (303 U.S. 218), Helvering against Gerhardt (304 U.S. 405), and Graves et al. against New York ex rel O'Keefe, decided March 27, 1939, extending the classes of officers and employees subject to Federal taxation.

SEC. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

SEC. 206. The terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code.

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treasury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

SEC. 209. In the case of the judges of the Supreme Court, and of the inferior courts of the United States created under article III of the Constitution, who took office on or before June 6, 1932, the compensation received as such shall not be subject to income tax under the Revenue Act of 1938 or any prior revenue Act.

SEC. 210. For the purposes of this Act, the term "officer or employee" includes a member of a legislative body and a judge or officer of a court.

SEC. 211. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Approved, April 12, 1939.